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IN THE

Supreme Court of the United States

October Term, 1947

No. 349

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,
A Debtor-Petitioner,

vs.

THE STATE OF NEW JERSEY,
A Creditor.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

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THE STATE OF NEW JERSEY,
A Creditor.

PETITION FOR WRIT OF CERTIORARI TO THE CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Walter P. Gardner, Trustee of The Central Railroad Company of New Jersey, a debtor corporation in bankruptcy under Section 77 of the Bankruptcy Act, petitions for a writ of certiorari to review a decision of the Circuit Court of Appeals for the Third Circuit reversing Order No. 260 of the United States District Court for the District of New Jersey sitting in bankruptcy.

Jurisdiction

Judgment of the Circuit Court of Appeals was entered July 15, 1947. The opinion of the Circuit Court of Appeals is not yet reported. A copy, however, is included in the record on file. The jurisdiction of this Court is invoked under Section 240(a) of the Judicial Code; 28 U. S. C., Section 347(a) as amended by the Act of February 13, 1925.

The Nature of the Proceedings

This case is a sequel to the decision in *Gardner* v. *New Jersey*, 329 U. S. 569. For the second time in succession the Circuit Court of Appeals has denied the jurisdiction of the Bankruptcy Court to decide an important issue in the proceedings of this debtor, and this time after having the guidance of this Court.

Petitioner is the surviving trustee of The Central Railroad Company of New Jersey, an interstate railroad which is in reorganization in the District Court of the United States for the District of New Jersey under Section 77 of the Bankruptcy Act. Debtor's petition for reorganization was filed on October 30, 1939.

The subject of this litigation is a claim formally filed by the State of New Jersey in the Bankruptcy Court on December 10, 1940, for the balance of taxes plus penalties alleged to be due for the years 1932 to 1939, inclusive. After the State had invoked the jurisdiction of the Bankruptcy Court by filing its claim, the Trustees filed detailed objections thereto, questioning on numerous grounds, the amount and legality of the principal sum claimed as well as of the penalties. One of the objections to the amount claimed was that it had been compromised for the amount specified in the so-called Tax Settlement Acts.

While the Special Master was hearing and considering the question of the jurisdiction of the Bankruptcy Court to determine the objections that had been made by the trustees and bondholders to the State's claim for taxes, the Attorney General of New Jersey, on December 5, 1944, served on the trustees a petition and notice of motion for an order granting the Attorney General leave to join the trustees of the debtor in an action to be instituted in the courts of New Jersey for a declaratory judgment to determine one of these objections, to wit:—whether the debtor and its trustees entered into a contract with the State of New Jersey pursuant to the provisions of Chaper 290 of the Laws of 1941 and Chapter 241 of the Laws of 1942, and whether such contract is binding on the parties thereto (Appellant's App. 134a, 135a).

The District Judge, after argument on this motion on December 11, 1944 and December 18, 1944 (Appellant's App. 137a-216a), signed Order No. 260 which, after reciting the motion and the hearing of argument by all parties in interest, provided:

> "And it appearing to the Court that to grant the relief prayed for in said petition would result in further and prejudicial delay in the hearing and adjudication of the State's claim and in the reorganization of the debtor and would not be in the public interest or in accordance with the intent of Congress in enacting Section 77 of the Bankruptcy Act;
>
> "It is, on this 18th day of December, 1944, ORDERED that the aforesaid motion be and the same is hereby denied" (App. 217a).

The Attorney General immediately appealed (App. 223a), alleging abuse of discretion by the District Judge (App. 218a).

Hearing of this appeal was deferred until the decision of this Court in *Gardner, Trustee* v. *New Jersey, supra*, which was decided by this Court on January 20, 1947.

The Circuit Court, in the decision to which this petition for certiorari relates, reversed the Bankruptcy Court. Seemingly disregarding the fact that the matter involved was the adjudication of a claim which the State had filed in the Bankruptcy Court and that the immediate question was whether the State had agreed to compromise the claim under Section 27 of the Bankruptcy Act, the Circuit Court apparently concluded that there was no abuse of discretion (see page 5 of the opinion), which was the question argued by the parties on appeal, but went further and held that that Court had erred as a matter of law in not automatically granting the State's motion on the theory that owing to the decree that had been entered by the Chancery Court of New Jersey in *Wilentz* v. *Hendrickson*, 133 N. J. Eq. 447, the District Court was forbidden to decide whether the State's offer could have resulted in a valid compromise.

Because of the wholly erroneous concepts of the majority of the Circuit Court of Appeals (see, in particular, Footnote 2, p. 6), it is necessary for us to point out the following essential facts which are referred to in the decision of this Court in *Gardner, Trustee* v. *New Jersey, supra.*

The State, on December 10, 1940, voluntarily filed in the reorganization proceedings its Proof of Claim No. 38, claiming that there was due to it for property taxes and interest assessed against the debtor for the years 1932 to 1939, inclusive, a balance of $19,849,790.21, plus additional interest, after payments on account had been made by the debtor before bankruptcy aggregating $18,128,962.82 (App. 75a).

The trustees and bondholders committees both filed objections and supplemental and amended objections to

this claim (App. 84a, 94a), to which objections the State filed a reply (App. 102a) asserting therein that under the New Jersey statutes the taxes assessed in each year bear interest from the date payable in each year until payment at the rate of one percent per month (App. 103a, Par. 2).

The Tax Settlement Act of 1941, Chapter 290, was passed by the Legislature and approved by the Governor on July 22, 1941. The trustees, on August 8, 1941, filed their petition with the court for instructions and for directions to them to compromise the claim of the State (Tr. App. 544a). The court in Order No. 123 authorized the trustees to compromise the State's claim for taxes (Tr. App. 552a). The form of undertaking executed by the trustees and delivered to the State, whereby the trustees agreed to pay the State its taxes in the way and manner required by Chapter 290, P. L. 1941, appear at Tr. App. 548a-551a. While the Attorney General failed to approve the form of the settlement papers, they were nevertheless executed and delivered on August 11, 1941 to and retained by the State Comptroller and State Treasurer respectively, without any disapproval of such forms by the Attorney General. The forms were approved in Order No. 123 dated August 8, 1941 (Tr. App. 552a).

On November 21, 1941 the trustees filed a petition with the District Court for instructions whether they should pay on or before December 1, 1941 taxes for the year 1941 that became due and payable on that date. This petition contains the recital that in compliance with Order No. 123 the trustees had filed with the Comptroller their undertaking to pay the State the taxes asserted to be due for the years 1932 to 1940, inclusive, with interest as prescribed by the Tax Settlement Act, and filed with the State Treasurer a waiver of all rights to contest the legality of all assessments made prior to December 1, 1941 and stipulations and consents to the discontinuance of the ap-

peals pending before the State Board of Tax Appeals for 1939, 1940 and 1941, and that:

> *"Up to this date, neither the trustees of the debtor nor the debtor have received any communication advising that said tender has been rejected nor have the certified checks tendered and delivered to the Treasurer of the State of New Jersey on August 11, 1941 been returned"* (Tr. App. 562a).

On the filing of the last mentioned petition the court required notice to be given to all parties.

A hearing was held November 24, 1941, the Attorney General not appearing (Tr. App. 566a). After such hearing the court made Order No. 135, which recites the giving of notice of the hearing and determines that the trustees had taken all the steps necessary on behalf of debtor's estate to comply with Chapter 290, P. L. 1941:*

> "That no objection has been made either by the Comptroller, or the Treasurer, or the Attorney General of the State of New Jersey to the trustees of the debtor, or to the debtor, or to any of said affiliated companies, or to this Court, as to the validity or form of any of the tenders, undertakings, waivers or stipulations filed by the trustees, to comply with said Chapter 290 on behalf of debtor's estate, etc."

The court thereupon ordered that the trustees pay to the State the 1941 taxes in full (Tr. App. 574a), and they were accepted by the State.

It was on September 4, 1941, *three weeks after the trustees had on August 11, 1941 filed their undertakings, waivers, etc.*, with the State Treasurer and State Comptroller, that the Attorney General commenced his information suit in the Court of Chancery attacking the constitutionality of the Settlement Act (App. 55a, Par. 16).

On May 21, 1942, the Governor approved Chapter 241, P. L. 1942 (Tr. App. 685a), which amended the Tax Settle-

* Printed in full, Tr. App. 680a.

ment Act of 1941. This act was in the form of an offer of compromise by the State to any railroad taxpayer "or the duly appointed and qualified receiver, receivers, trustee or trustees thereof" (Tr. App. 693a). The forms of acceptance and waiver, discontinuance and dismissal are contained in Sections 7 and 8 of this statute (Tr. App. 690a, 691a). This statute did not require any action of any kind by any State Officer. The day this act was approved by the Governor the Attorney General filed a supplemental civil information action and secured an injunction restraining the State Treasurer from accepting any payments under the terms thereof. The trustees, on June 2, 1942, filed with the court a petition for instructions whether they should comply with this law (App. 10a). The State and all other parties were required to show cause why the prayer of the petition should not be granted. On June 12, 1942 Order No. 163 was made directing the trustees, among other things, to comply with the amended Tax Settlement Act (App. 21a).

On June 22, 1944, the Court of Errors and Appeals, in *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, by a vote of ten to four, affirmed the decree of the Court of Chancery and held that the Tax Settlement Acts were void as in violation of Article 1, Par. 20 of the State Constitution, which provides that:

> "No donation of land or appropriation of money shall be made by the State or any municipal corporation to or for the use of any society, association or corporation whatever."

The decision gave no new construction to the New Jersey Constitution but followed the prior decisions in *In re Voorhees*, 123 N. J. Eq. 142, 121 N. J. L. 594, and 124 N. J. L. 35, which had held that a gift by the state to a private party was repugnant to the above quoted constitutional provision. The decree was based on this well settled principle of state law and on a finding of fact that

there was no consideration for the offer contained in the Settlement Acts.

This decision was placed squarely on the ground that the proofs did not show that the remission, cancellation and abatement of the delinquent interest (on taxes assessed against all railroads in the state) was supported by "legal, equitable or moral consideration." 135 N. J. Eq., at page 253. It is important to indicate that although on the State's initiative, a sharp issue of fact as to what amount was due on the State's tax claim was then pending in the Bankruptcy Court, the Attorney General made no application to the Bankruptcy Court to make the trustees or debtor parties to the chancery suit and obviously did not advise the State court of the existence of this issue or of the jurisdiction of the Bankruptcy Court to deal with it. Furthermore, the *Wilentz* case was decided on ex-parte affidavits and a stipulation of facts between the Attorney General and the State Treasurer. No witness was submitted to examination or cross-examination in open court by anybody. 133 N. J. Eq. 447; 135 N. J. Eq. 261.*

It was on August 14, 1944, within two months after the decision of *Wilentz* v. *Hendrickson* by the Court of Errors and Appeals that the Trustees filed in the Bankruptcy Court their "Petition for Adjudication Concerning New Jersey Tax Claims," App. 47, *et seq.*, which raised the questions decided in *Gardner* v. *New Jersey*, at the last term of this court, and fundamentally was the reason for the filing of the Attorney General's petition and motion on which Order 260, now under consideration, was made. It is obvious that the interminable litigation over the State's tax claims has been due to the State's insistence, concurred in twice by the Circuit Court of Appeals, that the Bankruptcy Court is without jurisdiction to decide the questions raised in proceedings there pending.

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* The decision in *State* v. *Erie R. R. et al*, 23 N. J. Misc. 203, on which the Circuit Court seems to place much reliance, was also decided on a stipulation of facts. Neither the Trustee nor the Debtor was a party.

The Decision Below

The Circuit Court of Appeals, with a dissenting opinion by Judge Goodrich, held that the decree in *Wilentz* v. *Hendrickson, supra,* an action in which neither the Debtor nor the Trustee was a party, and where the Attorney General was informant and the State Treasurer, alone, was defendant, is binding and conclusive on the debtor and its trustee and the whole world. It held that in the face of the State's decree enjoining the State Treasurer from accepting any payments under the Settlement Acts, the Bankruptcy Court is powerless to make an effective order, and that the Chancery Court decree affirmatively deprives the debtor of the rights and benefits of its compromise with the State of the State's tax claims, although this court in *Gardner* v. *New Jersey* had held this was one of the questions that might be decided by the Bankruptcy Court.

The Circuit Court further held that the *only* question at bar is whether there was a valid contract made between the Trustee and the State *under the Settlement Acts,* and that since the Bankruptcy Court could not change the chancery decree, "only by reference to that State forum (the Court of Chancery) can the problem be solved after which the injunction may be lifted to permit payments under contract or may be safely left intact because there is no contract".*

Disregarding this Court's opinion in *Continental Ill. Nat'l B. & T. Co.* v. *C. R. I. P. R. Co.,* 294 U. S. 648, 677, although citing it, the Circuit Court held that both the District Court and counsel for both parties were in error in treating this case as calling for the exercise of judicial discretion as to whether the issues involved should be referred to the State Courts for decision. It held that *only the New Jersey Court* could effectively de-

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* For a more extended analysis of the Circuit Court's opinion, see Point IV of appended brief, page 36.

cide the issue involved and that the action of the District Court in denying the Attorney General's petition was an error of law. Judge Goodrich, in his dissent, points out that the question involved might be

> "for one tribunal or the other. If the matter is one of discretion, that discretion is lodged in the District Court and not ourselves. We should uphold the action taken there unless we find that the exercise of discretion is not legally supportable" (Opinion p. 17).

He points out that the decision of the majority was not well taken when it determined that the Bankruptcy Court had somehow been deprived of authority which it otherwise has by the injunction in *Wilentz* v. *Hendrickson*, saying:

> "It needs no argument to establish the point that a statute passed by the Congress pursuant to a power granted it by the constitution becomes the supreme law of the land. The effective operation of this power is surely not to be interfered with by orders made in the intra-state operation by State governments in whatever functions they may be at the time performing" (Opinion p. 18).

Judge Goodrich's first point of dissent was from the decision that discretion was not involved. His second reason for dissent was because he thought:

> "the majority announces a very dangerous doctrine. It is inconceivable to me that the exercise of federal function by the Court acting under a statute in turn resting on a constitutional grant of power, can be interfered with by the fact that a State court has previously enjoined somebody from doing something" (Opinion p. 19).

Questions Presented

1. Is not the jurisdiction of the Bankruptcy Court so far as the compromising of any controversy arising in the administration of an estate is concerned, exclusive so as to require that the Bankruptcy Court, and it alone, pass upon all questions relating thereto, since this power is derived from Section 27 of the Bankruptcy Act, which is based on the Constitution?

2. Where Congress, in the exercise of its constitutional powers, has conferred upon the Bankruptcy Court jurisdiction to authorize the compromise of any controversy arising in the administration of an estate, are not such powers exclusive within the field in which Congress has acted and exclude the jurisdiction of any state to interfere therewith?

3. Is it a proper exercise of the jurisdiction of the Circuit Court of Appeals, conferred by 28 U. S. C., Sec. 225(c) (Judicial Code, Sec. 128 as amended); and 11 U. S. C. Sec. 47, to direct a trustee in bankruptcy to submit one objection to the allowance of a State's claim for taxes to a State court, and retain in the Bankruptcy Court, for later trial and decision, other objections to the claim with inevitable, interminable and unnecessary delay in the reorganization of the debtor?

4. Is it not error for a Circuit Court of Appeals, after reorganization proceedings have been pending for almost eight years, to refer one question incidentally, as it assumed, involving State law, to a State court for decision respecting a State's claim for taxes, when at the same time there are numerous other objections to the State's claim which must later be determined in the Bankruptcy Court should the State Court not decide completely in favor of the trustee.

5. Did not the Circuit Court err in concluding that the District Court had "no reasonable choice of alternatives upon which discretion could be exercised," when the substantive issue which the District Court refused to refer to a State Court was a mere issue of fact as to whether there existed considerations to support the State's offer of compromise?

6. Did not the Circuit Court err in holding that the Bankruptcy Court could not decide whether there had been a valid compromise of the State's claim on the ground that its decision could not be enforced without contravening a decree in the State Court against the State Treasurer?

Summary Statement of Matters Involved

The controlling facts in a nutshell are these:

The State had filed a very large claim for taxes and penalties. The Trustees and bondholders filed objections to this claim, the principal ones being:

(a) That the claim had been compromised and the State had been paid in full.

(b) That if it should be held that there was no compromise, then the payments made on account after bankruptcy by the Trustee, aggregating over $18,000,000, should be credited first to taxes rather than penalties, in accordance with the orders of the Bankruptcy court, rather than ratably between penalties and principal according to state law.

(c) That if any balance then appeared to be due on the State's claim, the Bankruptcy Court should adjudicate the amount remaining due with proper regard to the

equities that had arisen from actions taken by the Trustees, under instructions of the Bankruptcy Court and in reliance on the Settlement Acts, before the decision in *Wilentz* v. *Hendrickson* (*supra*).

(d) That any penalty interest included in the State's claim should be disallowed by the Bankruptcy Court in view of the provisions of Section 57 (j) of the Bankruptcy Act; that no interest should be allowed after the petition was filed, and in no event should more than interest at the rate of 6% per annum be allowed.

(e) That if finally any amount is found to be due to the State, to what assets of the Debtor does the State's lien attach and does such lien have priority over the lien of the mortgage securing the Debtor's bonds as to the various assets of the Debtor.

It thus appears that there are five major questions of vital importance concerning the State's claim, each of which can only be finally decided by the Bankruptcy Court and over which no other court can possibly have jurisdiction.

The Circuit Court of Appeals, in its opinion, says:

> "The only question at bar is whether there is a valid contract under the State Act, as the Debtor contends."

The Trustee contends that he has under valid orders of the Bankruptcy Court compromised the State's claim filed in the bankruptcy proceeding.

It is true that the petition filed by the Trustees for approval of the compromise as well as the petition for adjudication referred to a contract of settlement with the State, in accordance with the terms of the Tax Settlement Acts. If a contract was consummated, however, it was obviously a compromise consummated under Section 27 of the Bankruptcy Act and the State Statute entered into the matter only by way of providing the ways and means by which the claim filed by the State might be compromised.

The power of the Bankruptcy Court to compromise such a claim is given by Section 27 of the Bankruptcy Act, 11 U. S. C. 50, which provides:

> "The Receiver or Trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate."

The basis for settlement of the claim of the State which was presented to the court by the Trustees was a compromise in accordance with the provisions of the Tax Settlement Acts under said Section 27 of the Bankruptcy Act. The Bankruptcy Court had full and complete jurisdiction to entertain such a compromise under said section.

The Circuit Court of Appeals has ruled as a matter of law that the question of compromise cannot be decided by the Bankruptcy Court and that the decision on all other questions involved, as raised by the Trustees' objections to the State's claim, over which questions this court has held that the Bankruptcy Court has exclusive jurisdiction, must await the decision of the State Court on the validity of the compromise. Such decision certainly seems to be directly in conflict not only with *Gardner* v. *New Jersey, supra,* but also with *Public Utilities Commission* v. *United Fuel Gas Co.,* 317 U. S. 456; and *Continental Illinois B. & T. Co.* v. *C. R. I. & P. Co.,* 294 U. S. 648.

REASONS WHY WRIT OF CERTIORARI SHOULD ISSUE

FIRST: The Circuit Court has so far departed from the accepted and usual course of judicial procedure as to call for an exercise of this Court's power of supervision.

A

In *Gardner* v. *New Jersey, supra,* this Court said:

> "We only hold that the reorganization court could properly entertain all objections to the claim (of the State) except those involving the valuations underlying the assessments and the validity of those assessments." 329 U. S. 565 at 584.

The Circuit Court of Appeals has held that the question whether or not there was a compromise of the State's claim is "A question which only one court can effectively decide",—that is, the State court.

Without the benefit of any proofs, Master's report or District Court decision which this Court in its opinion (*supra*) called for, the Circuit Court held that the trustees' efforts to comply with the Tax Settlement Acts were "vain" (page 2) and that "The existing Chancery decree affirmatively deprives the debtor of the rights and benefits of its alleged contract with the State".

The decision of the Circuit Court is unprecedented. The question submitted by the appeal and briefs and argued by the parties was whether or not the Bankruptcy Court had abused its discretion in denying the State's motion for an order granting the Attorney General leave to join the trustees of debtor in an action to be instituted in the courts of New Jersey for a declaratory judgment to determine whether the debtor and its trustees had entered into a contract with the State pursuant to the

provisions of the Settlement Acts, and whether such contract is binding on the parties hereto.*

The Circuit Court of Appeals instead of deciding the question briefed and argued before it held that "In this situation, we do not find it necessary to decide whether or not there was an abuse of legal discretion by the District Court. There was an error of law."

The opinion does not specify what error of law the court had in mind, although this court in *Gardner* v. *New Jersey* clearly indicated that judicial discretion was involved. The Circuit Court reversed the District Court's order, and in effect directed that the question whether or not a compromise of the tax claim was consummated should be referred to the New Jersey Court of Chancery for decision. The opinion frankly concedes that the court's action is "unusual." The court cites *Union Tool Co.* v. *Wilson*, 259 U. S. 107, for the proposition that the exercise of discretion cannot justify the failure of the court "to apply well-settled law to a conceded state of facts", and *In re Sobol*, 242 Fed. 487, for the proposition that such a failure constitutes a reversible error of law. The court, however, gave no indication as to what principle of law it deemed to be "well-settled" or what state of facts it deemed to be "conceded".

Both the law and the facts involved in this litigation are sharply in issue. In the *Tool Company* case, *supra*, and the *Sobol* case, *supra*, as the opinions make clear, the controlling principles of law were well-settled and the pertinent facts were indisputable. In both of those cases it was clear that a court order had been violated, and in such a situation the settled law required a finding of contempt. No question of discretion was presented. Here, as the court itself, in another portion of its opinion,

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* This was the language of the Attorney General. The question involves not a contract pursuant to the Settlement Acts, but a compromise under Section 27 of the Bankruptcy Act.

recognizes: "A real controversy is presented between the parties * * *" (Opinion, p. 14).

The controversy is as to whether or not a compromise was effected, or, if not, whether rights had accrued to the debtor's estate under the facts and circumstances and under express provisions of the Bankruptcy Act and principles of equity, which the Bankruptcy Court should determine. How can it be deduced from the cases cited that a Bankruptcy Court having jurisdiction of such a controversy must automatically refer one of the questions involved to a State court on the application of the creditor whose claim is disputed by the trustee in bankruptcy?

Judge Goodrich in his dissenting opinion said:

> "It seems to me that the sole question in the case before us is whether the reorganization court committed reversible error in declining to order the debtor and trustees to become parties to litigation in the New Jersey State courts involving questions of whether, following the declaration of the unconstitutionality of the Settlement Acts, petitioner has rights growing out of conduct, or agreement, or what not, prior to that declaration" (Opinion p. 17).

It is submitted that the procedural question raised by the State's motion in the Bankruptcy Court was one peculiarly calling for the exercise of discretion.

B

The majority opinion of the Circuit Court reaches an anomalous conclusion. The opinion states (page 8):

> "In brief, if a decision of the court below on the substantive issues would contravene the existing injunction, the denial by that court of New Jersey's request to determine them in a state court was error. If such a decision would not contradict the injunction,

> the denial was correct, and the matter is one wholly of federal concern. Hence to decide whether the answers are the task of one jurisdiction or the other requires some inquiry into what the decision of the lower court would be. If the Acts are clearly void *ad hoc* and if there is clearly no contract to sustain the Acts' provisions, then the district court judgment is to be affirmed. Otherwise a reference to the state courts for a determination of the issues is inescapable."

In effect, the majority opinion holds that the Bankruptcy Court has power to determine the issues before it only if those issues can be decided in favor of the State but that if there is any possibility of the issues being decided adversely to the State, then the Bankruptcy Court has no power to adjudicate them.

This conclusion by the majority of the Circuit Court seems contrary to all accepted concepts of jurisdiction of a federal court. The jurisdiction or power to adjudicate an issue under our jurisprudence presupposes corresponding power to issue a decree in favor of either party, as the facts and the applicable law may warrant. In the words of Mr. Justice Holmes, "Jurisdiction is authority to decide the case either way". *The Fair Co.* v. *Kohler Specialty Co.*, 228 U. S. 22 at 25. The determination made by the majority of the court below, that jurisdiction may be exercised in favor of one party but may not be exercised in favor of the other, seems such a departure from the accepted and usual course of judicial procedure as to call for the exercise of this Court's power of supervision.

This Court recently emphasized in *United States* v. *Standard Oil Co.*, 91 L. Ed. 1507 (Adv. Ops.), that while *Erie* v. *Tompkins*, 304 U. S. 64, requires that in diversity cases controlling effect must be given by federal courts to state law in matters of State interest, there is no warrant in

the law "for broadening state power over matters essentially of federal character."

The requirement of uniform national administration of federal statutes requires that the federal courts exclusively should administer federal law.

For all of the above reasons it is submitted that the issue presented by the State's motion was one peculiarly calling for the exercise of discretion; that the Bankruptcy Court exercised a sound discretion in denying the motion; and that, therefore, the Circuit Court's decision is erroneous and should be examined by this Court.

SECOND: The Circuit Court has decided an important question of Federal law which has not been, but should be settled by this Court.

The Circuit Court has held that when a trustee files objections to the allowance of a State's claim for taxes filed in the proceedings, asserting that with court approval he accepted an offer to compromise made by the State, the District Court must refer the question whether there has been a compromise to a State court for decision as soon as the State makes a motion to that effect.

Here the offer to compromise was made in two public statutes both passed by the Legislature and approved by the Governor, which are the most formal offers of compromise that a sovereign state can make. The trustees upon the passage of the first statute reported the offer of compromise to the court, which ruled that the offer be accepted. When the next Legislature passed and the Governor approved the second statute amending the first, the trustee with court approval accepted that offer and complied with it.

When the trustee, after the decision in *Wilentz* v. *Hendrickson*, *supra*, was announced, petitioned the court to determine whether the claim had been compromised and if not what amount should be allowed thereon, and

the nature, extent and priority of the State's lien, questions of federal law, and federal law only were thus presented to the Bankruptcy Court for decision.

Congress enacted the Bankruptcy Act pursuant to the express power given by Article 1, Sec. 8 of the Constitution. Section 2 of the Bankruptcy Act (11 U. S. C. Sec. 11) creates bankruptcy courts, "with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act * * *." It gives them power to

> "(2) Allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates." 11 U. S. C. A. Sec. 11(2), as amended June 22, 1938.

Section 77(c)(7) provides that the judge shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced; and Section 77(c)(13)(l) provides that:

> "In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors * * * shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

Section 77(f) of the Bankruptcy Act, 11 U. S. C. Sec. 205(f), provides:

> "Upon confirmation of the plan, the debtor and any other corporation or corporations organized or to be organized for the purpose of carrying out the plan, shall have full power and authority to, and shall put into effect and carry out the plan and the orders of the judge relative thereto, under and subject to the supervision and the control of the judge, *the laws of*

any state or the decision or order of any state authority to the contrary notwithstanding.'' (Italics ours.)

Congress has so completely taken over jurisdiction of bankruptcy matters that it required the provisions of Section 67(7)(e), 11 U. S. C. A. Sec. 107, to give concurrent power to state courts to entertain suits for the recovery of assets and set aside fraudulent transfers.

So complete is this power that upon the filing of a petition in bankruptcy state courts then administering jurisdiction over the bankrupt must give way, and even the fees of officers of the state court must be allowed and ordered paid by the Bankruptcy Court.

Straton v. *New*, 283 U. S. 318;
Isaacs v. *Hobbs Tie & Timber Co.*, 282 U. S. 734;
Gross v. *Irving Trust Co.*, 289 U. S. 342;
Bankruptcy Act, Sec. 2(21), 11 U. S. C. Sec. 11(21), as amended June 22, 1938, C. 575 Sec. 1, 52 Stat. 842.

Nevertheless the rule as now announced by the Circuit Court would surrender to State courts one of the powers (to allow claims) expressly conferred on courts of bankruptcy by Congress in Section 2 of the Bankruptcy Act. Even if the State court should attempt to decide the question, the Bankruptcy Court could ignore its decision under the express language of Section 77(f), ''the laws of any State or the decision or order of any State authority to the contrary notwithstanding''. This demonstrates the wisdom of the decisions in *Public Utilities Commission of Ohio* v. *Gas Company*, 317 U. S. 456, 463 and *Continental Illinois Nat'l Bank & Tr. Co.* v. *Chicago Rock Island & Pacific R.R. Co.*, 294 U. S. 648, and the futility of the decision below.

Side by side with the question whether there was a compromise under Section 27 of the Bankruptcy Act is a question of equity; whether, in view of the offer made by

the State in a public statute approved by the Governor, the action of the trustees in accepting the tendered offer of compromise, the concomitant filing of a written undertaking to pay the taxes as assessed in full, the discontinuance of all contests against taxes then pending in administrative tribunals and the courts as to some of which the debtor's estate has had no hearing and as to others of which there was no remedy under state law, and the making of payments on account that would not otherwise have been made, equities have arisen in favor of the debtor's estate that entitle it to have the State's claim allowed either in the amount fixed by the Tax Settlement Acts or such other sum as to a Chancellor would seem equitable and fair to all parties in interest. The virtue in such an equitable defense is shown by the decisions of *Trenton Street Railway Co.* v. *Lawler,* 74 N. J. Eq. 828; *Cutting* v. *Dana,* 25 N. J. Eq. 265; *Headley* v. *Leavitt,* 68 N. J. Eq. 591 (E & A); *Union Central Life Insurance Co.* v. *Insland,* 91 Fed. (2d) 365 (CCA 8th). Moreover, the recent decision of this Court in *Vanston Bondholders Protective Committee* v. *Green,* 329 U. S. 156, illustrates the power and authority of the bankruptcy court over the allowance of interest on claims filed in the proceedings.

We have found no reported case where there has been a reference to a State court to make a determination as to whether a claim in bankruptcy has been compromised, or to determine equitable defenses to such a claim. In *New Jersey* v. *Anderson,* 203 U. S. 483, 491, the Bankruptcy Court reduced the amount of a State's claim for taxes to the amount it found to be due. The present case is the first in which it has been held that when a trustee objects to the allowance of a state's claim the Bankruptcy Court as a matter of law must refer the question for decision to the courts of the claimant State. No wonder that Judge Goodrich in his dissenting opinion referred to the decision of the majority as announcing "a very dangerous doctrine"!

THIRD: The Circuit Court of Appeals has decided ederal question in a way probably in conflict with licable decisions of this Court.

The decision below appears to be in conflict with the sion of this Court in *Gardner* v. *New Jersey, supra.* Court remanded "the cause to the District Court for her proceedings in accordance with this opinion" and opinion found that "the issues (including the Settle- t Act and the contract question) can be resolved by reorganization court on a record more adequate than present one for purposes of review." The Circuit rt of Appeals, disregarding the mandate of this Court, on a record void of any facts essential to its deter- ation, itself determined as a matter of law that the rict Court could not effectively decide the question lved and that the Bankruptcy Court was powerless to with the State's claim until the decree in *Wilentz* v. *drickson* was lifted by the Chancellor. If that were law, this Court would have so declared it at the last in *Gardner* v. *New Jersey,* where the record was sub- tially the same as this.

Likewise the decision of the Circuit Court is probably onflict with the decision of this Court in *Public Utility mission of Ohio* v. *Gas Co.,* 317 U. S. 456, at 463, that:

> "where, as here, no state court ruling on local law could settle the federal questions that necessarily re- main, and where, as here, the litigation has already been in the federal courts an inordinately long time, considerations of equity require that the litigation be brought to an end as quickly as possible."

In this case, as in that, no State Court ruling on local would finally settle the Federal questions that are lved. Moreover, since this litigation arises under Sec- 77 of the Bankruptcy Act, 11 U. S. C. A. Sec. 205, and

has been pending nearly eight years, considerations of public interest peculiarly call for expedition. *Continental Bank etc.* v. *Chicago Rock Island etc.*, 294 U. S. 648. The Circuit Court of Appeals has fallen into error by ignoring the above quoted rule and by failing to follow the decision in *Gardner* v. *New Jersey* last term.

Wilentz v. *Hendrickson, supra,* commenced September 4, 1941, although tried on affidavits and stipulations of fact, was not decided until July 20, 1943, by the Court of Chancery, and was affirmed by the Court of Errors and Appeals June 22, 1944. It is not likely that such litigation as the Attorney General wishes to bring could be concluded in the State courts in less time than this. Moreover, the New Jersey State courts will not entertain an action for declaratory judgment where there is another adequate remedy at hand. *Empire Trust Co.* v. *Board of Commerce & Navigation,* 124 N. J. L. 406; *Provident Mutual Life Ins. Co.* v. *Unemployment Compensation Comm.,* 126 N. J. L. 348 (E. & A.).

Necessarily a suit in the State courts for a judgment, declaratory or otherwise, would determine whether a compromise had been effected between the State and the debtor under Section 27 of the Bankruptcy Act. Any such action if permitted, and if entertained by the State courts, would amount to a complete surrender to the courts of the creditor State of the inherent, fundamental jurisdiction of the Bankruptcy Court under one of the express provisions of the Bankruptcy Act. If the decision below stands the trustee will be obliged to appear in and defend such declaratory judgment suit as the Attorney General may bring in the State courts. The trustee should not be put to the hazard of the rule that a judgment on the merits in one suit is *res judicata* in another where the parties and subject matter are the same, not only as respects matters actually presented to

sustain or defeat the right asserted, but also as respects any other available matter which might have been presented to that end. *Baltimore S. S. Co.* v. *Phillips,* 274 U. S. 316, 319; *Grub* v. *Public Utilities Comm.,* 281 U. S. 470; *Chicot County Drainage Dist.* v. *Baxter State Bank,* 308 U. S. 371.

The decision of the Circuit Court, by giving controlling effect to the decision in *Wilentz* v. *Hendrickson, supra,* also conflicts with the decision of the Circuit Court of Appeals of the Eighth Circuit in *City of Beatrice* v. *Edminson,* 117 Fed. 427, where Judge Sanborn said, at page 431:

> "It is only when the legal conclusion of a State court relative to the constitutionality of a statute of its state is based upon the same facts, upon the same statute, that it controls the decision of the federal courts upon that question. The determination of the issues of fact which conditioned the terms and passage of a statute, like the finding of any other issue of fact, concludes no one, either in a State or in a federal court, except the parties to the action in which the decision is rendered and their privies."

Furthermore, the Circuit Court by giving controlling effect to the decree in *Wilentz* v. *Hendrickson,* based as it is upon findings as to which the Trustee has had no hearing, squarely involves a denial of due process in direct disregard of this court's decisions in *Brinkerhoff-Faris Co.* v. *Hill,* 281 U. S. 673 (1930).

The Circuit Court decision completely overlooked the rule announced by this Court in *New Jersey* v. *Anderson,* 203 U. S. 483, at 491, that while the meaning of a state statute presents a question of state law yet "where rights, the subject of adjudication by the Federal Courts, have accrued before its construction by the State Court, or the question of contract within the protection of the Federal

Constitution is involved, still a State Court, while entitled to great consideration", cannot conclusively decide the Federal questions in issue.

Finally, the decision below is in conflict with *Woodson* v. *Murdoch*, 22 Wall. 351. The State of Missouri had a claim against the Pacific Railroad Company for $10,500,000, which was compromised under an act of the Legislature for $5,000,000. Thereafter the State attempted to enforce its lien for the compromised taxes and the District Court issued a permanent injunction. On appeal to this Court it was contended that the act of the Legislature under which the taxes were compromised violated the Constitution of the State and hence all acts done pursuant to it were void. This Court affirmed the award of a permanent injunction and held that the Fifth Section of the Missouri Act of March 31, 1868 was not in conflict with that provision of the State Constitution which forbade for any purpose whatever the release of a claim held by the State upon any railroad. The jurisdiction in that case was given to the federal courts because of diversity of citizenship.

It is unthinkable that a court of bankruptcy must make such a complete abdication of its responsibility and jurisdiction as the court below requires.

Prayer

For the foregoing reasons your petitioner prays that a writ of certiorari may issue out of this court to the United States Circuit Court of Appeals for the Third Circuit, commanding said Court to certify and send to this Court on a day to be determined, the full and complete transcript of the record of all the proceedings of such Circuit Court of Appeals had in this case, to the end that the case may be reviewed and determined by this Court; that the judgment of the Circuit Court of Appeals

may be reversed, and that petitioner be granted such other and further relief as may be proper.

Dated: September 15, 1947.

WALTER P. GARDNER,
Surviving Trustee of The Central
Railroad Company of New Jersey,

By JAMES D. CARPENTER, JR.,
Counsel for the Trustee,
75 Montgomery Street,
Jersey City 2, New Jersey.

ALEXANDER H. ELDER,
SAMUEL M. COOMBS, JR.,
Of Counsel.

BRIEF IN SUPPORT OF PETITION

Opinion Below

The District Court filed no opinion. The opinion of the Circuit Court is not yet reported but is on file and will be printed by the Clerk with the record below.

Statement of the Case

A summary statement of the case is given in the petition, page 12 above. This matter arises on a motion of the Attorney General for leave to make the Trustees parties defendant in a declaratory judgment suit to be brought in the courts of his own state to determine one objection made by the Trustees to the allowance of the State's claim as a creditor filed in the proceedings. The District Court decided that to grant the motion would result in further and prejudicial delay in the adjudication of the State's claim and in the reorganization of the debtor's estate and would not be in the interest of the estate, or in accordance with the intent of Congress in enacting Section 77 of the Bankruptcy Act, and denied the motion. Although this court held in *Gardner* v. *New Jersey* that the District Court had jurisdiction to decide all the objections that the Trustees had made to the allowance of the State's claim, nevertheless the Circuit Court of Appeals held that the District Court erred as a matter of law in not granting this motion of the Attorney General. If correct the inevitable result of the judgment of reversal will be to delay debtor's reorganization probably for two or three years and will deprive the Bankruptcy Court of jurisdiction granted it by Congress to pass upon a question expressly within the provisions of the Bankruptcy Act.

POINT I

Exercise of discretion by the district judge was involved in the appeal below.

The Circuit Court said that if judicial discretion "were the only question present, the problem could be determined quite simply in favor of the Federal Court". It then held that it was error of law for the Bankruptcy Court not to refer one objection made by the trustees to the allowance of the State's claim to the State courts for decision. Since this Court in *Gardner* v. *New Jersey, supra,* had expressly held that the reorganization court had jurisdiction to pass upon every objection made by the trustees to the allowance of the State's claims, this case falls squarely within the language of the opinion in *Continental Illinois Bank & Trust Co.* v. *Chicago, Rock Island & Pacific Ry. Co.,* 294 U. S. 648, 677, as follows:

> "It presents a question addressed not to the power of the court but to its discretion—a matter not subject to the interference of an appellate court unless such discretion be improvidently exercised."

In re Youtie, 44 Fed. (2d) 56, CCA 3rd;
Newburger Coal Co. v. *Ruffner Bros.,* CCA 4th, 165 Fed. Rep. 881;
Nisbit, Commissioner v. *Federal Title & Trust Co.,* CCA 8th, 229 Fed. Rep. 644;
Field v. *Kansas City Refining Co.,* 296 Fed. 800.

POINT II

The decree of the Court of Chancery does not, and cannot, affect the debtor or the administration of its estate.

The Circuit Court of Appeals said (p. 6 of the Opinion) that the final decree of the Court of Chancery in *Wilentz* v. *Hendrickson* stated that

> "* * * the Settlement Acts are unconstitutional as to the world. There is the permanent New Jersey injunction against action by the State Treasurer, without whose acceptance of tax payments nothing can be done. Whether any New Jersey court has really passed on the constitutionality of the Settlement Acts as to the debtor and whether any such court has really meant there is no contract will be considered below. At the moment, however, it is enough to point out that an existing judgment of a sovereign power has said both of those things.
>
> "* * * The injunction which is still in effect would render both such assumed actions nugatory."

Again, the court said that the same injunction would bar the way to a tender to the State in fulfillment of the contract.

Again,

> "If either contention of the debtor is sound, the injunction must be dissolved" (Opinion, p. 7).

The decree of the Court of Chancery appears in the Appellant's Appendix, page 92a.

The first paragraph of this decree adjudges that Chapter 290, P. L. 1941 and Chapter 241, P. L. 1942 are unconstitutional.

The second paragraph permanently restrains and enjoins the State Treasurer and his successors in office, their servants and agents, from carrying out or executing any of the provisions of either of said laws, "and from accepting from any railroad taxpayer any acceptance documents, discharges or dismissals, discontinuance, checks or other forms of payment which may be delivered to him or them, or which were heretofore delivered to him or them in purported compliance with" said statutes.

The decision of the Circuit Court disregards the provisions of Section 77(b) and 77(f) of the Bankruptcy Act and ignores the controlling effect of the confirmation of a plan of reorganization. If the Bankruptcy Court orders payments in discharge of the State's claim to be made either in cash or securities, the injunction of the Court of Chancery above quoted would not be violated by the acceptance of the dividend on the claim by the State Treasurer. This injunction did not operate to prevent the State Commissioner of Finance from accepting $15,250,000.00 from the trustee on account of the State's claims on May 6, 1946 (See Order No. 333 and Commissioner's Receipt, Tr. App. 671a, 674a).

Under settled law the decree in the Court of Chancery was binding only upon the parties to that action.

Rutten v. *Paterson*, 73 N. J. L. 467, 475;
City of Beatrice v. *Edminson*, 117 Fed. 427, J. Sanborn.

POINT III

There is no uncertainty as to the law of New Jersey.

Judge Goodrich in his dissenting opinion said:

> "Questions of state law arise in bankruptcy all the time and it is part of the federal judge's ordinary function to deal with them in his stride and when they arise."

In a footnote the Judge lists a great number of cases to sustain this statement.

Here, there is no uncertainty as to the State law as in *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, because it has been settled by the decisions in *In re Voorhees, supra,* and *Wilentz* v. *Hendrickson, supra.* On a trial it may be necessary for the trustee to establish that there was consideration for his settlement with the State. What is adequate consideration under the laws of New Jersey is thoroughly established.

Grandin v. *Grandin,* 49 N. J. L. 508, 514;
National Bank v. *Bloom,* 113 N. J. L. 597, 602 (E & A);
Restatement Law of Contracts, Vol. 1, Sec. 75.

It is submitted that in a case like this the Federal courts will themselves construe the Tax Settlement Acts as well as the New Jersey Constitution. See,

Woodson v. *Murdoch,* 22 Wall. 351;
Meredith v. *Winterhaven,* 320 U. S. 228.

The Railroad Tax Settlement Act of 1941 contains this provision:

"12. Effect of Unconstitutionality.

If any provision of this Act, or the application thereof to any person or circumstances, is held invalid, the remainder of this Act, or application of such provision to other persons or circumstances, shall not be affected thereby."

The same provision was contained in Section 15 of the Amendment of 1942.

Under New Jersey law,

"A decision based upon stipulated facts that results in declaring a law unconstitutional does not wipe the act from the statute books, but merely denies its efficacy to a party who has admitted the existence of a state of facts that in the opinion of the court renders the law unconstitutional" (Pitney, J., in *Rutten* v. *Paterson*, 73 N. J. L. 467, 475).

Moreover, under the decisions of the New Jersey Court of Errors and Appeals, a duly enacted statute is not null and void even though later declared unconstitutional, and actions taken in good faith under the statute are effective, certainly, when taken prior to any challenge. *Allison* v. *Corker*, 67 N. J. L. 596; *Lang* v. *Bayonne*, 74 N. J. L. 455; *Attorney General* v. *McGuinness*, 78 N. J. L. 346; *Eastwood* v. *Russell*, 81 N. J. L. 672; *In re Public Utility Board*, 83 N. J. L. 303 (1912). Especially is this true when the facts applicable to the particular situation were not before the court but only facts contained in a stipulation, which did not represent the facts in the case of the Jersey Central.

See also in *Chicot County Drainage District* v. *Baxter State Bank*, 308 U. S. 371; *Phipps* v. *School District of Pittsburgh* (C.C.A. 3d), 111 Fed. (2d) 393; *J. A. Dougherty's Sons* v. *Commissioner of Int. Rev.* (C.C.A. 3d), 121 Fed. (2d) 700.

While in most of the New Jersey cases cited, as in the case at bar, the action taken was before any challenge had been made, in *Attorney General* v. *McGuinness, supra,* the Court of Errors and Appeals indicated that the existence of a bare challenge does not vary the local New Jersey rule. In that case it said (at pages 371, 372):

> "For such mistaken conception leads to the radical error, that, if duly challenged, a legislative act will be sustained only when it is demonstrably constitutional. Such a notion in effect supplements the constitution by requiring the affirmative concurrence of all three departments of the government where that instrument of the organic law requires but two, viz., the legislative and the executive * * *."

The debtor's relinquishment of all further rights to contest in the State tribunals and Courts, whether by express waiver or by allowing time to lapse, was first made under authority of Order No. 123 in acceptance of the 1941 Settlement Act, three weeks before the Attorney General filed his information action. The 1942 Act was amendatory of and supplemental to the 1941 Act, and Order No. 163, responsive to the 1942 Act, was necessary to protect a change in status already made in reliance upon the earlier Act. Such a state of affairs justified, if indeed, it did not require, the Bankruptcy Court to order compliance upon the principle that the legislative offer was the law of the state until declared unconstitutional. (See Order 163, 29a.)

Wilentz v. *Hendrickson* (*supra*), was decided on a stipulation of facts made between the State's Attorney General and Treasurer. The decision of the Court of Errors and Appeals, based on this stipulation, held that the Tax Settlement Acts amounted to an appropriation of money to corporations in violation of Art. 1, par. 20 of the State Constitution.

In reaching its conclusion the Court said (at p. 253):

"Thus if the state has a vested right in and to the tax debt (delinquent interest), then unless the remission, cancellation and abatement of that right is supported by a 'legal, equitable or moral consideration' (*In re Voorhees*, 123 N. J. Eq., 142) the challenged statutes clearly contravene, in spirit and in fact, the constitutional limitation (Art. 1, par. 20) invoked."

Again, at page 260, the Court said:

"Nor do we find anything in the proofs to support a moral or equitable consideration."

A trifling inconvenience to the one party or a slight advantage to the other is sufficient to constitute lawful consideration. *National Bank* v. *Bloom*, 113 N. J. L. 597, 602 (E. & A.). " 'Consideration' in the legal sense of the word, of a contract is the *quid pro quo*, that which the party to whom a promise is made does or agrees to do in exchange for the promise." *Phoenix Mutual Life Insurance Company* v. *Raddin*, 120 U. S. 183.

Restatement of the Law of Contracts, Vol. 1, Sec. 75.

The legislature in paragraph 15 of 1942 Tax Settlements, New Jersey (App. 694-698a), specified the consideration which it determined the State was receiving.

There is no force to the contention of the Attorney General, which has repeatedly been made, that there was no settlement effected with the State because of his wilful refusal to approve the settlement papers delivered under the 1941 Act.

It is a principle of elemental justice that if a promissor (offeror) is himself the cause of the failure of performance, either of an obligation due him or of the condition

upon which his own liability depends, he cannot take advantage of the failure.

Williston on Contracts, Vol. III, Sec. 677, page 1952;
United States v. *Peck,* 102 U. S. 64;
Greenwood v. *Watson,* 171 Fed. 619;
United States v. *Behan,* 110 U. S. 338;
Tanenbaum v. *Francisco,* 110 N. J. L. 599;
Realty Acceptance Corp. v. *Montgomery* (C. C. A. 3rd), 51 Fed. (2d) 636;
Restatement of Contracts, Sec. 63.

It was on September 4, 1941, three weeks after the trustees had on August 11, 1941 filed their undertakings, waivers, etc., with the State Treasurer and State Comptroller, that the Attorney General commenced his information suit in the Court of Chancery attacking the constitutionality of the Settlement Acts (App. 55a, Par. 16).

POINT IV

The Decision of the Circuit Court of Appeals denies the supremacy of the Bankruptcy Court over the Courts of the States in matters affecting the Estate.

In its decisions in *Thompson* v. *Magnolia Petroleum Co.,* 309 U. S. 478 and *Mangus* v. *Miller,* 317 U. S. 178 this court, while holding that questions concerning the title to lands were properly referrable to state courts on the facts of those two cases, was careful to state that meanwhile the status quo in bankruptcy should be preserved.

It is impossible to preserve the status quo here because the state asserts that interest on its claim is running

at the rate of 1% per month, or over $1,000,000 per year, if the state's contentions should ultimately prevail.

When the Circuit Court of appeals said

> "There is the final New Jersey decree stating the Settlement Acts are unconstitutional as to the world. There is the permanent New Jersey injunction against action by the State Treasurer, without whose acceptance of tax payments nothing can be done."

it ascribes to the decree force and effect that is recognized by no authorities.

Moreover it is a flat denial of the supremacy of the bankruptcy act (Sec. 77) in railroad reorganizations, and in effect is a holding that State law is supreme unless and until the State Court elects, on petition, to open its decree.

Again, when the opinion declares that a decision in favor of debtor by the Bankruptcy Court and a tender of payment by the Trustee would be rendered nugatory by the State Court Injunction it reiterates its doctrine of supremacy of state over bankruptcy law.

The utter fallacy of the reasoning on which the judgment sought to be reviewed is premised is shown in footnote 2 to the opinion which indicates that the Court was of the belief that the State's claim (filed December 10, 1940) was filed under the provisions of the Settlement Acts (passed in 1941 and 1942) and questions the power of the State to file such claim in the bankruptcy proceedings. It ignores the facts as contained in the claim actually filed (App. 75a), as well as the statements of this Court in *Gardner* v. *New Jersey* that

> "he who invites the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide the consequences of that procedure;" and

> "The whole process of proof, allowance, and distribution is, shortly speaking, an adjudication of interests claimed in a res."

When the Court below said (Pg. 11 of the opinion) that debtor's contentions that the state's claim was compromised under Section 27 of the Bankruptcy Act (11 U. S. C. 50) and its claim of equitable defenses are "contentions of no moment on this appeal" it ignored the real bankruptcy issues involved and substituted as the only question at bar whether there was a contract under state law, in the language of the Attorney General in his motion and points on appeal.

The Trustee contended below that even though the Settlement Acts were held to be unconstitutional by the State Courts in *Wilentz* v. *Hendrickson,* nevertheless the Trustees, by accepting the offer contained in Section 7 of the 1941 Act and in the 1942 Act, with the approval of the Court, and complying therewith before the question of constitutionality was raised or determined, had secured rights and benefits for the debtor's estate which the later state court decree could not affect under the decisions in *Chicot County Drainage District* v. *Baxter State Bank,* 308 U. S. 371, 374; *Allison* v. *Corker,* 67 N. J. L. 596; *Lang* v. *Bayonne,* 74 N. J. L. 455; *Attorney General* v. *McGuinness,* 78 N. J. L. 346; *Eastwood* v. *Russell,* 81 N. J. L. 672 and *In re Public Utility Board,* 83 N. J. L. 303. The Circuit Court of Appeals announces a new doctrine, to wit: that the decision in *Wilentz* v. *Hendrickson,* which merely held the Settlement Acts to be unconstitutional, also overruled the line of cases which hold that a duly enacted statute is an operative fact and that actions taken in good faith under it before it is held void are effective. There is no judicial sanction for such a doctrine.

In brief, all through the opinion of the Circuit Court runs the fallacious notion that before the debtor's estate

can obtain a decision on the numerous and vital bankruptcy questions involved, the injunction against the State Treasurer must be dissolved.

Probably the most harmful finding of the Circuit Court (Pg. 8) is that a decision of the Bankruptcy Court would contravene the State Court injunction and that it was error of law for the District Judge to deny the motion of the Attorney General for leave to join the Trustee as defendant in an action to be brought in a State Court. This finding concedes the supremacy of the State Court injunction over Debtor's estate; it would result in permitting a State Court to pass upon questions as to the amount for which a state's claim in bankruptcy should be allowed, and finally would delay debtor's reorganization, perhaps for years.

The State's claim is so large (now approximately $16,000,000) that reorganization cannot be effected until it is finally determined by the Bankruptcy Court.

It is respectfully submitted that a writ of certiorari should issue to the Circuit Court of Appeals for the Third Circuit as prayed for in the annexed petition.

JAMES D. CARPENTER, JR.,
Counsel for Trustee.

ALEXANDER H. ELDER,
SAMUEL M. COOMBS, JR.,
Of Counsel.

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IN THE

Supreme Court of the United States

October Term, 1947 — No. 349

WALTER P. GARDNER, Trustee of The Central Railroad Company of New Jersey,
A Debtor-Petitioner,

vs.

THE STATE OF NEW JERSEY,
A Creditor-Respondent.

REPLY TO BRIEF OF THE STATE OF NEW JERSEY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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Reply to Respondent's "Statement"

There are two assertions of fact in the respondent's "Statement" which might prove misleading.

First: On page 3 in respondent's brief in describing the waivers which were required to be filed in order to comply with the offer of compromise contained in the Settlement Acts, the respondent states that:

> "The proposed waiver covered the years 1932 to 1936, inclusive, notwithstanding that there was no conceivable chance of further contest concerning such years."

The fact is that the waivers filed by the petitioner as required by the Settlement Acts not only covered the con-

tested taxes for the years 1932 to 1936, inclusive, but also the taxes for the years 1937 to 1941, inclusive. The respondent could not and, therefore, does not suggest that the taxes for those years were not open to contest since the record shows that as to the years 1937 and 1938 the petitioner, as a necessary condition of complying with the Settlement Acts, waived the right to a judicial review and as to the years 1939 to 1941, inclusive, it waived the right even to a hearing by the Board of Tax Appeals.

Second: At page 5 of respondent's brief, the opinion of Judge Maris *In Re Central Railroad Company,* 136 Fed. (2d) 633, is quoted to the effect that:

> "The tender (provided for by the Settlement Acts) though acknowledged was not accepted by the Treasurer and consequently was without legal effect. In fact the Treasurer was powerless to accept the tender by reason of the injunction issued by the Court of Chancery."

And on page 7 it is asserted that:

> "there could not have been the requisite performance by the petitioner in order to comply with the Settlement Acts."

This persistent assertion of the respondent completely disregards the fact (a) that the original tenders constituting the Trustee's acceptance of the State's offer of compromise contained in the first Tax Settlement Act (Chapter 290, P. L. 1941) were filed with the State Treasurer on August 11, 1941, while the jurisdiction of the Court of Chancery was not invoked until the filing of the civil information suit on September 4, 1941, and (b) that the second Tax Settlement Act (Chapter 241, P. L. 1942) was so framed as to constitute an offer of compromise by the

State which could be accepted by "any railroad tax payer desiring to accept the provisions of this Act" by complying with the State's conditions and without calling for any action whatever by any State officer or official.

Judge Maris' conclusions were erroneous because the very essence of the question of the settlement and compromise of the State's claim involved in this litigation is (1) that the petitioner unquestionably waived valuable rights as a necessary condition of accepting the State's offers contained in the Tax Settlement Acts and (2) that though the first Tax Settlement Act required the approval (merely a ministerial act) of the State Attorney General of the undertakings and waivers filed by the trustee, which constituted his acceptance of the State's offer of compromise contained in the first Tax Settlement Act, the second Tax Settlement Act provided for the consummation of a compromise which did not involve any action, ministerial or otherwise, by any State official. The petitioner having surrendered valuable rights, as hereinbefore pointed out, in order to accept the State's offers of settlement and compromise contained in the two acts, it is obvious that the injunction, imposed by the Court of Chancery in the case of *Wilentz* v. *Hendrickson*, against only the State Treasurer, could not in any way affect, or preclude the acceptance by the Trustee of the State's offers of settlement and compromise made in public statutes.

Reply to Respondent's "Argument"

On page 11 of the respondent's brief it is asserted that the well settled New Jersey rule, that a statute held unconstitutional is not void ab initio and that actions taken in good faith under the statute may be effective, has been repudiated by the decision in *Hyman* v. *Long Branch Kennel Club,* 115 N. J. L. 123. An examination of the latter decision will make clear that while it criticizes a dictum in *Lang* v. *Bayonne,* 74 N. J. L. 455, it expressly states that "we have no present quarrel" with the essential point decided in that case. As stated in our original brief (p. 33 and p. 38), it is today the settled law in New Jersey that rights may have become vested under a statute subsequently held unconstitutional. In fact, following the Hyman decision, the Court of Errors in *Byrnes* v. *Boulevard Commissioners,* 121 N. J. L. 497 (1939), affirmed the doctrine of the *Lang* case, on which we rely. This doctrine has peculiar force in a case, like the present, where a new party is involved and the holding of unconstitutionality was based on a stipulation of facts between other parties.

Neither the State's brief nor the brief of Jersey City, as *amicus curiae,* attempts to justify the *reasoning* of the Third Circuit's opinion. The State's brief at page 14 explains that said court misunderstood the State's argument and in the following pages (pp. 15 to 17, inc.) labors to so explain the decision as to justify the "result" on the theory that the court below did not mean what it clearly said. Jersey City's brief (p. 4) frankly opens its argument by saying, "We submit that *regardless of the reasoning,* etc." of the Third Circuit Court and then boldly announces (p. 10):

> "Both the majority and minority opinions in the Circuit Court of Appeals concluded that the doctrine of

> the *Spector Motor, Inc.* case (*supra*) was inapplicable here for the reason that in that case the State statute involved had not been previously construed. We respectfully dissent from that asserted distinction."

The immediate question before this court is not on the merits but on whether the Third Circuit's decision has so far departed from the accepted and usual course of judicial procedure as to call for review by this Court. On that question we submit that regardless of the result reached in the decision, if its reasoning was clearly unsound, then the case calls for a review by this court. This is so because if the decision in its present form stands it will promulgate what Judge Goodrich describes as "a very dangerous doctrine" (App. 47) and may lead to endless confusion in the future administration of the Bankruptcy Act.

As indicated by the recent decision of this court in *Meredith* v. *Winter Haven*, 320 U. S. 228, the rule is that it is "the duty of the Federal courts, if their jurisdiction is properly invoked, to decide questions of State law whenever necessary to the rendition of a judgment". The State seems to recognize how "dangerous" it would be to require Federal courts to refer questions of local law to State courts in other than exceptional situations by stating:

> "The *Meredith* case did not present those special circumstances which dictated the application of the above-mentioned equitable rule in the cited cases. Had this Court held otherwise than it did, then there would have been authority whereby in every diversity of citizenship case the jurisdiction of the District Court could be denied if some undecided question of local law should be raised."

Likewise, if the opinion of the Third Circuit were permitted to stand, it may result that in countless cases arising under

the Bankruptcy Act, where State law questions are constantly arising, the Bankruptcy Courts may feel obliged to interrupt their proceedings while questions are referred to State courts and thus one of the primary objectives of the Bankruptcy Act will be defeated.

As Chief Justice Stone in *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89 at 95, said:

> "The bankruptcy act prescribes its own criteria for distribution to creditors. In the interpretation and application of federal statutes, federal not local law applies. (Many cases cited.)'
>
> "See also *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 162-3."

Respectfully submitted,

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Oct. 17, 1947

ALEXANDER H. ELDER,
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947

No. 349

WALTER P. GARDNER, Trustee of the CENTRAL RAILROAD COMPANY OF NEW JERSEY,

A Debtor-Petitioner,

vs.

THE STATE OF NEW JERSEY,

A Creditor-Respondent.

BRIEF OF THE STATE OF NEW JERSEY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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IN THE

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vs.

THE STATE OF NEW JERSEY,

A Creditor-Respondent.

BRIEF OF THE STATE OF NEW JERSEY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

(Italics ours unless otherwise indicated.)

STATEMENT.

The issue below was very narrow. The Court was asked to decide whether certain questions of local law presented by the Trustee's petition of August 12, 1944 to the Bankruptcy Court (App. 71a), should be referred to the State Court for authoritative determination. The State believes that this Court has spoken completely and convincingly on this question, that the exceptional circumstances of the instant case fully justify the application of the rule

which requires such reference to the State Courts and that, if the Third Circuit had not held as it did, this Court of its own motion, would have directed such reference as it did in *Spector Motor Service* vs. *McLaughlin,* 323 U. S. 101.

The word "required" has been used advisedly. The several leading cases whereby this Court has established the rules applicable to such reference were not concerned with any alternative courses that might be followed at the discretion of the lower court in the given case. In every instance the lower court had sought to exercise its discretion by retaining the whole cause and answering the questions of local law as a matter of jurisdictional right. In each of such cases this Court reversed the lower Court and held that, under the special circumstances of the given case, there was no alternative course—the lower court as a matter of duty was required to refer such questions of local law to the State Court for determination.

The tax litigation concerning the defaulted taxes of the Debtor is summarized in a previous decision of the Third Circuit. (152 F. (2d) 408, 411, affirmed in part and reversed in part by *Gardner* vs. *New Jersey,* 329 U. S. 565.) It is clear that, when, on April 20th, 1941, this Court denied certiorari to review a judgment adverse to the several railroad companies with respect to their tax assessments (313 U. S. 568), the validity of the tax assessments for the years 1931 to 1936, inclusive, had been fully established.

Thereafter, the New Jersey Legislature passed the first so-called tax settlement act on July 22nd, 1941. (P. L. 1941, Ch. 290). By section 1 of that Act it was provided that:

> "The State Treasurer is hereby authorized and required to accept, without interest penalties, installment payments of the full principal amount of property taxes upon railroad companies, which were due on or before December first, one thousand nine hundred and forty, and remain unpaid on the effective date of this act. But the State Treasurer shall not accept any in-

stallment payments under the terms of this act unless and until the delinquent taxpayer shall have complied with the requirements of sections seven and eight hereof."

By sections 7 and 8 of the said Act, provision was made for the executing and filing of a written undertaking for payment "in such form as the Attorney General shall prescribe" and for the filing at the same time of a waiver of any right to contest the legality or amount of any assessment "all in such form as the Attorney General may require." The proposed waiver covered the years 1932 to 1936, inclusive, notwithstanding that there was no conceivable chance of further contest concerning such years.

The Attorney General, believing that the said Act was unconstitutional, filed a Civil Information in the New Jersey Court of Chancery on September 4, 1941, praying that the said Court should determine the constitutionality of the said Settlement Act and for injunctive relief.

Prior to this action by the Attorney General, the Trustees attempted on August 7, 1941, to make a pretense of compliance with the said Act, notwithstanding that they were unable to obtain the approval of the documents as set forth in the said sections 7 and 8 and specifically required by section 1 of the said Act as a condition precedent to the enjoyment of the benefits and privileges thereof. That the Trustees fully recognized that they had not complied with the Act and that they had simply made a tender, which must await the determination of the New Jersey Courts with regard to the question of constitutionality, is shown by reference to the minutes of hearing before the United States District Court on November 24, 1941 (App. 566a, et seq.) wherein Counsel for the Debtor stated at page 570a:

"Wherefore, the reservation asked is to protect the jurisdiction of this Court to determine the amount and

> the legality of the taxes in the event that the tender is not accepted because in that event our waiver would not be effective; and the Attorney General would be here to claim the amount of taxes alleged to be due and to have the amount determined by this Court."

The just mentioned hearing was held with respect to the payment of 1941 taxes, which under the Act of January 8, 1934 (28 U. S. C. A., Sec. 124(a)) were clearly the obligation of the Trustee who was operating the railroad. The tender mentioned was the alleged tender of August 7, 1941.

It was generally admitted that so long as the Attorney General, who was contesting the constitutionality of the said Settlement Act, refused to participate in the settlement procedure, no railroad company could effectively take advantage of the original Settlement Act. In order to permit the several railroad companies to enjoy the benefits of the settlement procedure, notwithstanding the refusal of the Attorney General to participate, the New Jersey Legislature on May 21, 1942, adopted a second Settlement Act. (P. L. 1942, Ch. 241.) This Act eliminated the requirement that the Attorney General approve the settlement documents. Instead, the Act itself set forth the form of such documents.

On the very day that the second Act was adopted, the Attorney General filed a supplemental information and applied for a temporary restraining order, enjoining the State Treasurer from carrying out or executing any of the provisions of the Acts. The restraining order was signed the same day.

The Federal Courts have already considered the effect of that injunction in *In re Central Railroad Company,* 136 F. (2d) 633. When, notwithstanding the said temporary restraint, the Bankruptcy Court entered its order No. 163 on June 12, 1942, adjudging that the claims of the State should be allowed in the amount prescribed by the Settle-

ment Acts, the Third Circuit reversed the said order holding that the Bankruptcy Court in the exercise of a nice discretion should have stayed its hand pending the determination by the State Courts of the question of constitutionality. Certiorari was denied by this Court (320 U. S. 805).

In the said case Judge Maris said for the Court with respect to the issue of performance (page 638):

> "[5] The final contention that the issue between the state and the trustees is moot by reason of the tender to the Treasurer of a payment pursuant to Order No. 163 must also fail. The tender though acknowledged was not accepted by the Treasurer and consequently was without legal effect. In fact the Treasurer was powerless to accept the tender by reason of the injunction issued by the Court of Chancery."

The just-mentioned case was decided on May 27, 1943. Thereafter, the New Jersey Court of Chancery determined that the Settlement Acts were unconstitutional (*Wilentz* vs. *Hendrickson,* 133 N. J. Eq. 447), and on September 28, 1943, the said Court made its final decree providing for a permanent restraint. (App. 92a.) This decree was affirmed by the New Jersey Court of Errors and Appeals on June 22, 1944. (135 N. J. Eq. 244.)

On August 12, 1944, the Trustee filed with the Bankruptcy Court a petition entitled "Petition for Adjudication Concerning New Jersey State Tax Claims." (App. 47a.) By such petition the Trustee prayed that the Court promptly adjudicate "(1) whether petitioner entered into a contract with the State of New Jersey, (2) whether such contract was binding on the parties thereto, (3) whether, if not binding on the State, petitioners are none the less bound by the prejudicial actions taken by them."

In addition, the petition set forth defenses to the New Jersey State tax claims including the claims for the years

1932 to 1936, inclusive, which had been finally and completely litigated as shown above. Believing that the Bankruptcy Court did not have jurisdiction to hear further those questions long since made res adjudicata, the State filed its general objection to the jurisdiction of the Court.

In the meantime, notwithstanding the State's objection to the Bankruptcy Court's jurisdiction, the said Court proceeded to undertake the determination of meritorious questions without first determining the jurisdictional question. Being compelled to go forward, the State, on December 9, 1944, filed its notice of motion and petition for an order granting the Attorney General of New Jersey leave to join the Trustees of the Debtor in an action to determine whether or not there is any contract with the State of New Jersey arising out of the Settlement Acts, the self-same questions submitted to the Bankruptcy Court by the petition of August 12, 1944. (App. 134a, 135a.) On December 18, 1944, the Court entered its Order No. 260 denying the State's motion. The State immediately took an appeal from this order. Thereafter, the Court did proceed to determine the jurisdictional questions, the appeal from the Order No. 260 being meanwhile held pending a final determination of the said jurisdictional questions.

This Court in *Gardner* vs. *New Jersey, supra*, held with the State that the Bankruptcy Court could not properly entertain objections to the claim "involving the valuations underlying the assessments and the validity of those assessments." This Court held that otherwise there is jurisdiction. It therefore became necessary to continue with the appeal from Order No. 260. From the opinion in the *Gardner* case (page 583) it is clear that this Court was fully aware of this pending appeal.

It is perfectly apparent that the Legislature did not grant to the several railroad companies any rights by the mere passage of the Settlement Acts. Nor did the said Settlement Acts take away from or deny to the said railroad

companies any rights previously held by them. The Legislature simply sought to prescribe a procedure whereby any one of the defaulting railroad companies could avail itself of certain benefits or privileges upon certain definite terms. As a condition precedent to the enjoyment of such benefits or privileges, the applying railroad company was required to do certain things in a definite and fixed manner.

There has never been a time when any railroad company has been in a position to perform the conditions precedent to the enjoyment of the benefits and privileges of the Settlement Acts. It is difficult to understand therefore just what manner of action could be taken by the Bankruptcy Court whereby the benefits or privileges of the Settlement Acts could now be made available to the railroad companies or anyone of them—just how such Court could provide for the performance of the conditions precedent to such enjoyment. Judge Maris apparently fully comprehended the true situation when he made the observation, cited herein at page 5, in *In re Central Railroad Company, supra.*

Were this the only question of local law that confronted the State in the bankruptcy proceedings, the determination of such question would present no serious problem to the Bankruptcy Court. The State respectfully submits that the Federal Courts must find that there could not have been the requisite performance just as Judge Maris has held heretofore.

But such is not the case. This is only one of many more difficult questions. In the words of Mr. Justice Douglas, the issues "bristle with questions of New Jersey law." Because of the utter confusion that would result on account of the inability to keep the several wholly independent issues of local and federal law properly segregated and, in the interest of the orderly determination of the several issues, the State has requested that questions of local law presented by the Trustees' petition of August 12, 1944, as more particularly set forth above, shall be sub-

mitted to the State Court where such questions may be authoritatively determined. The Third Circuit has directed that the State's motion in regard thereto be granted.

The State's argument in opposition to the granting of the Writ of Certiorari will be confined to showing that there are important questions of local law that must be answered and that the special circumstances of the instant case bring the said case so clearly within the rules heretofore firmly established by this Court that no other result could properly have been reached. Those special circumstances require that such questions of local law be referred to the State Court for authoritative determination.

ARGUMENT.

POINT I.

The petition of August 12, 1944, presents important questions of State law.

The prayers of the Trustees' petition of August 12, 1944, requesting the Bankruptcy Court to make determinations with respect to certain contract rights alleged to have arisen by reason of the passage of the Settlement Acts are set forth at page 5 herein. There can be no doubt but that the said petition presents several important questions of State law. Although not within the issues presented by the State's jurisdictional objections, this very question was argued at length by the Trustee when the jurisdictional question was before this Court in *Gardner* vs. *New Jersey, supra.* The State felt compelled to answer such argument.

The Trustee again made the same argument in the Court below in the instant appeal as he made before this Court in the *Gardner* case. The Trustee has presented a summarized version of a similar argument in his present petition and brief whereby he seeks a review of the judgment of the Third Circuit, which directs that certain questions

of local law be referred to the State Court. The language of this Court in the *Gardner* case is both informative and instructive. Mr. Justice Douglas said for this Court (page 582):

> "New questions of local law emerge—whether *Wilcntz* vs. *Hendrickson, supra,* controls this case; whether a valid settlement can be made under an unconstitutional act and, if so, whether this alleged compromise was valid and effective; whether, if the settlement was not binding, the amount of the claim or the extent of the lien has been altered by the payments made during reorganization or by the conduct of the parties."
>
> "These issues bristle with questions of New Jersey law on which we should not pass, even if we were to assume they are properly here, without the benefit of the views of judges who sit there and have a greater familiarity with local law and local practices than we. See *Huddleston* vs. *Dwyer,* 322 U. S. 232, 237, 64 S. Ct. 1015, 1018, 88 L. Ed. 1246; *Brillhart* vs. *Excess Insurance Co.,* 316 U. S. 491, 497, 62 S. Ct. 1173, 1176, 86 L. Ed. 1620; *City of Hammond* vs. *Schappi Bus Line,* 275 U. S. 164, 169, 48 S. Ct. 66, 68, 72 L. Ed. 218; *Wilson Cypress Co.* vs. *Del Pozo Y. Marcos,* 236 U. S. 635, 656, 657, 35 S. Ct. 446, 454, 59 L. Ed. 758. And for a review of the earlier cases, see dissenting opinion of Mr. Justice Brandeis in *Railroad Commission of California* vs. *Los Angeles R. Co.,* 280 U. S. 145, 164, 165, 50 S. Ct. 71, 76, 77, 74 L. Ed. 234. Moreover, we are now advised that there is presently pending before the Circuit Court of Appeals an appeal by the Attorney General of New Jersey from an order of the reorganization court denying leave to join the trustee as party defendant in a suit in the New Jersey courts to determine whether there was a valid settlement of the tax claims and to stay further determination of

> that controversy in the federal court until the state courts have passed on the question. If the Circuit Court of Appeals orders the application granted, cf. *Thompson* vs. *Magnolia Petroleum Co.*, 309 U. S. 478, 483, 60 S. Ct. 628, 630, 84 L. Ed. 876; *Ex parte Baldwin, supra,* 291 U. S. p. 619, 54 S. Ct. 555, 78 L. Ed. 1020, the state law phases of the controversy will be authoritatively settled. If the other course is followed, the issues can be resolved by the reorganization court on a record more adequate than the present one for purposes of review. Whatever procedure is followed it is more fitting that those more versed than we in the intricacies and niceties of New Jersey law first pass on these questions."

The Trustee has again stated at page 32 of his brief that there is no uncertainty as to the State law "because it has been settled by the decisions in *In re Voorhees, supra,* and *Wilentz* vs. *Hendrickson, supra,*". Of course, if all of the questions have been settled by the said decisions, then there would remain no issues such as those presented by the first three prayers of the petition of August 12, 1944, concerning the existence of a contract. That the Trustee does not mean what he appears to have said is shown by the very next sentence on page 32 concerning the proof of the requisite consideration to make the Settlement Acts valid. Likewise, if the law has been settled by the all inclusive decree of the New Jersey Chancery Court, the statement of the Trustee in the next paragraph on page 32 to the effect that "it is submitted that in a case like this the Federal courts will themselves construe the Tax Settlement Acts as well as the New Jersey Constitution" is meaningless because the Federal Court must follow the State Courts on questions of local law.

In his zeal to impress upon this Court that there is no uncertainty in the law, the Trustee has again cited *Allison* vs. *Corker,* 67 N. J. L. 596; *Attorney General* vs. *McGuin-*

ness, 78 N. J. L. 346; *Eastwood* vs. *Russell*, 81 N. J. L. 672; and *In re Public Utility Board*, 83 N. J. L. 303 (1912), just as he did in *Gardner* vs. *New Jersey, supra*. The Trustee has added *Lang* vs. *Bayonne*, 74 N. J. L. 455, which case was mentioned by the State in the *Gardner* case. The State showed at that time that, with respect to an act specifically proscribed by the State Constitution, the rule of *Lang* vs. *Bayonne* has long since been definitely repudiated. And so with respect to the other just mentioned cases.

Notwithstanding that the State, in the *Gardner* case, called the Trustees' attention to *Gimbel* vs. *Peabody*, 114 N. J. L. 574 (Sup. Ct. 1935), wherein the Court said, at page 577:

> "The argument that the prosecutor is in laches because large expenditures have been made is without merit. Those who can read can understand the constitutional provisions of this State, and if they choose to expend their money in defiance of the clear mandate of the people, they must take the consequences. Time may not inure to the advantage of those who choose to flout the constitution of the state."

and to *Hyman* vs. *Long Branch Kennel Club*, 115 N. J. L. 123 (C. of E. & A. 1935), wherein the Court of Errors and Appeals repudiated the rule of *Lang* vs. *Bayonne, supra*, with respect to an act passed in violation of the gambling clause of the New Jersey Constitution, and held such an act void from the beginning, the Trustee has studiously ignored those cases.

The Court below in its opinion clearly demonstrated that there are important questions of State law when the said Court stated that there is the unsolved problem of whether the New Jersey Courts would hold the relationship created by the passage of the Settlement Acts contractual in nature. It is self-evident that the answer to that question forms the keystone to the several questions posed by the

first three prayers of the Trustee's petition of August 12th, 1944.

But that is not the only question of local law that might confront the Court with respect to the Settlement Acts. In *Wilentz* vs. *Hendrickson*, 133 N. J. Eq. 447, 462, 463 are set forth several other provisions of the State Constitution which, in the opinion of the Attorney General, were violated by the said Settlement Acts. Because the Court found that the said Acts violated Article I, Section 20 of the State Constitution, it found it unnecessary to "express an opinion concerning the other particulars in which the constitutionality of the statutes is impugned," (page 488). Such questions will again emerge if it should be determined that the Settlement Acts do not contravene Article I, Section 20 of the State Constitution.

In conclusion of this point, the State respectfully submits that it has been demonstrated that "these issues bristle" with important questions of State law.

POINT II.

Controlling decisions of this Court require that, under the special circumstances of the instant case, certain questions of State law should be referred to the State court for authoritative determination.

To support the just mentioned principle the State called to the attention of the Court below *Thompson* vs. *Magnolia Petroleum Co.*, 309 U. S. 478, *Railroad Commission of Texas* vs. *Pullman Co.*, 312 U. S. 496, *Chicago* vs. *Fieldcrest Dairies*, 316 U. S. 168, *Spector Motor Service* vs. *McLaughlin*, 323 U. S. 101, and in *In re Central Railroad Company*, 136 F. (2d) 633, which cases in the opinion of the State were authority for the rule that, when the special circumstances exist, a Federal Court is required to refer difficult questions of local law to the State Court where such ques-

tions may be authoritatively determined. The State then set forth the special circumstances that bring the instant case within the rule.

The Trustee has apparently misconceived the function of the Federal Courts in so far as questions of State law are concerned. This Court has left no doubt in this regard. The last word with respect to questions of local law belongs to the State Courts. *Railroad Commission* vs. *Pullman, supra.* When the State Court has made an authoritative determination, that determination is controlling.

A similar problem was squarely before this Court, in *Meredith* vs. *Winter Haven,* 320 U. S. 228, wherein the claim was made that, "although they appear on the record to be adversary litigations they were not in fact vigorously contested." Chief Justice Stone said with respect to such argument (page 234):

> "While the rulings of the Supreme Court of Florida in the Andrews case must be taken as controlling here unless it can be said with some assurance that the Florida Supreme Court will not follow them in the future, see *Wichita Royalty Co.* vs. *City National Bank,* 306 U. S. 103, 107; *Fidelity Trust Co.* vs. *Field,* 311 U. S. 169, 177-178; *West* vs. *American Telephone & Telegraph Co.,* 311 U. S. 223, 236, we assume, as the Court of Appeals has indicated, that the Supreme Court of the State may modify or even set them aside in future decisions."

It was never intended nor has it ever been held that the Federal Courts may afford a forum where determinations of questions of local State law by State Courts may be overruled or overturned at the caprice of a Federal District Court. Unless, therefore, the Federal Court in exercising its jurisdiction to determine questions of State law in the instant case would be in a position to say with some degree

of assurance that the law as expressed in *Wilentz* vs. *Hendrickson, supra,* would not be followed by the New Jersey Courts, if the said local questions were before the said New Jersey Courts, a Federal Court would be bound to follow the rulings in the said case.

There are no decisions in New Jersey that would lead to the conclusion that the New Jersey Courts would change the rule expressed in *Wilentz* vs. *Hendrickson, supra.* On the contrary, *New Jersey* vs. *Erie Railroad Co.*, 23 N. J. Misc. 203 (N. J. Sup. 1945), and *Murphy* vs. *West New York,* 132 N. J. L. 111 (N. J. Sup. 1944), indicate clearly that the New Jersey Courts will "follow" the decision in *Wilentz* vs. *Hendrickson, supra.*

Nevertheless, because the Trustee has raised the issues and because in the final analysis the State will be benefited by having the several issues untangled and each answered in its separate turn, the State has urged that certain questions of local law should be referred to the State Courts for determination.

The Court below in some manner understood the State's argument to mean that the Bankruptcy Court has, under the facts of the instant case, a "reasonable choice of alternatives upon which discretion could be exercised." (C. C. A. Record, page 44.) Such was not the purport of the State's argument. Nor is it the purport of the several cases which were cited as authority for the State's contention that, where the special circumstances exist, the local questions must be referred to a State Court for determination.

At page 20 of the brief below, the State said:

> "The principle stated in the above case is not novel but is a fixed and certain rule so that it would appear that the recent decisions of the United States Supreme Court and of this Court in *In re Central Railroad Co.*, 136 F. (2d) 633, leave no doubt but that, under the facts of this case, sound discretion *requires* that the Bank-

ruptcy Court should call to its aid and assistance the New Jersey Courts."

and at page 22 of the Reply Brief, the State said:

"If there is presented by this cause the circumstances that make abstention from the exercise of jurisdiction advisable because of 'a scrupulous regard for the rightful independence of the State Governments' then the failure to refer that question constitutes an abuse of discretion. The cases cited by the Trustee in support of his rule are not in point. They do not answer the rule so firmly established by *Railroad Commission* vs. *Pullman, supra; Thompson* vs. *Magnolia Petroleum, supra; Chicago* vs. *Fieldcrest Dairies, supra; Spector Motor Company* vs. *McLaughlin, supra,* and by the opinion of this Court in *In Re Central Railroad Company,* 136 Fed. (2d) 633, 638."

The State spoke of the use of discretion in the sense in which this Court used the expression in the several cited cases. It is clear that this Court was using the expression in the sense that it was used by the Court in *Quinn* vs. *Gardner,* 32 F. (2d) 772, 774, when it said:

"The appellate courts generally adhere to the rule that they will not interfere with these discretionary orders unless there is an abuse of such discretion, 'or an improvident exercise thereof,' the meaning is the same, namely, an error of law."

The State used the term in the same sense. There never existed any choice of alternatives under the special circumstances of this case.

The court below obviously was troubled by the thought that with a final decree in existence, such as in the instant

case, there could remain such a thing as discretion. And it is not surprising that anyone trained in equitable principles should shudder at the very thought of the conflict that would ensue were the Federal Court to arrive at an ultimate determination that is in conflict with that decree.

It must be remembered that there was only one railroad tax controversy continuously and concertedly carried on by all of the important railroad companies. The Legislature had before it only one particular condition or situation, that created by the concerted default of the same railroad companies excepting only the Pennsylvania Railroad Company. *Wilentz* vs. *Hendrickson, supra* (135 N. J. Eq. 244, 260,) shows clearly that the New Jersey Court sought to deal with the very taxes which are the subject of the State's present tax claims. For that reason the Court below quite obviously felt that, as a matter of law, so long as the existing decree should remain, there could be no decision by any but a State court designed to upset that decree.

The opinion below shows clearly that, in the opinion of the majority of the Court, any questions concerning the existence of a binding contract with the State of New Jersey by reason of the applicability of the Settlement Acts must be submitted as a matter of law to the State Court for determination. It is likewise clear that the said Court intended that the cause should be held in the Bankruptcy Court and that further work in the litigation will, under certain circumstances, be conducted in the Federal Court after the determination by the State Court of the local questions. There is no question of the abandonment or ceding of jurisdiction. Jurisdiction is retained at all times pending the aid of the State Court in the determination of local questions only. Such is the rationale of the cases cited above, all of which will be developed in greater detail hereafter.

Judge Goodrich in his dissent admitted the difficulty of the questions presented but believed that those questions

should be answered by the Bankruptcy Court. The State respectfully submits that the learned Judge has failed to distinguish between the existence of a power and the propriety of using that power under a given set of facts. He has failed to appreciate the distinction between an abandonment or cession of jurisdiction and the holding of an action in abeyance pending the seeking of the aid of a State Court in order to obtain an authoritative determination on a question of State law. He has failed to recognize that through a series of wise decisions this Court has developed in our law an equitable principle that recognizes the need of a harmonious working arrangement between State and Federal Courts operating within their respective spheres, an equitable principle that is becoming as deeply engraved within the body of our law as those ancient maxims that have proved so beneficial to the proper functioning of the instrumentalities of justice through these many years.

There can be no real distinction between error in law based upon failure to be bound by a final decree of a State Court to the extent that, as a matter of law, any local questions disputing the effects of such decree must be referred to such State Court, and error in law because of the impropriety of determining such matter in the Federal Court because of the existence of the same decree. In either event the purpose is exactly the same—to have the State Court pass upon the matter. In either event the result is the same, the State Court passes upon the questions after the Trustee has been heard. In neither case is it intended that the earlier decision shall of itself be controlling.

The State respectfully submits that the Court below meant no such distinction. The Court below was troubled by the use of the word "discretion," notwithstanding that this word had been used so many times by this Court in the controlling cases, and could not bring itself to countenance any situation which would make it appear that there was "a choice of alternatives upon which discretion could be exercised" in the given case.

The State will first present the several cases which form the basis of the equitable principle which requires that, when the special circumstances appear, questions of local law shall be referred to a State court. Thereafter there will be presented those special circumstances which the State believes warrant the application of the rule.

A. The Controlling Cases.

The State has placed reliance upon the four leading cases set forth in detail hereafter.

Thompson vs. *Magnolia Petroleum Co.*, 309 U. S. 478.

This Court in *Gardner* vs. *New Jersey, supra,* when discussing the question of referring questions of local law to the State Court mentioned the *Thompson* vs. *Magnolia Petroleum Co.* case. The said case involved a railroad reorganization under section 77 of the Bankruptcy Act. The Trustee had filed a petition seeking to protect his asserted interest in subsurface oil rights. The Bankruptcy Court had granted the prayers of the petition. The Eighth Circuit reversed the judgment holding that under the Illinois law the Trustee did not have title. Two broad questions were involved: (1) Whether the Bankruptcy Court had jurisdiction? and (2) Whether that Court should answer the questions of local law? This Court in reversing the Eighth Circuit said (page 483):

> "A court of bankruptcy has an exclusive and nondelegable control over the administration of an estate in its possession. But the proper exercise of that control may, where the interests of the estate and the parties will best be served lead the bankruptcy court to consent to submission to state courts of particular controversies involving unsettled questions of state property law and arising in the course of bankruptcy

> administration. And, under the circumstances of this case, we conclude that it is desirable to have the litigation proceed in the state courts of Illinois. * * *"

This Court then ordered that the cause be remanded to the District Court with instructions to modify its order so as to provide appropriate submission of the question of fee simple ownership of the right-of-way to the Illinois State Courts.

At first blush there appears to be a contradiction in the stated rule. Why if there was an exclusive and non-delegable control should a matter of local law have been sent to a State Court, particularly when the Bankruptcy Court had already ostensibly exercised its discretion and kept the cause in the Bankruptcy Court? An analysis of the case shows that there was no contradiction. The jurisdiction was always in the Bankruptcy Court. Such jurisdiction was never abandoned or ceded. The case established not a contradiction but a definite distinction. This Court distinguished between the power to assert jurisdiction with respect to a particular question arising in the course of the conduct of a cause and the propriety of exercising that jurisdiction in a given cause.

There is no doubt but that the District Court did attempt to answer the question of local law. The Circuit Court likewise made such attempt only to arrive at a different result. There was no doubt but that, if there was a choice of alternatives, the lower Court had made its choice and exercised its discretion by answering the local questions in the exercise of its admitted jurisdiction.

This Court decreed, as a matter of law, that by reason of certain facts the particular question belonged in the State Courts. In short, there was no choice of alternatives under the special circumstances of that case. There was only one permissible course—reference to the State Courts. Failure to provide for that course constituted reversible

error. This Court while at all times maintaining the integrity of the jurisdiction of the Federal Courts in bankruptcy matters saw fit to require the utilization of the facilities afforded by the State Court in aid of the federal jurisdiction.

Railroad Commission vs. *Pullman,* 312 U. S. 496.

This case involved the interpretation of a regulatory order alleged to be unauthorized by Texas law as well as violative of the Federal Constitution. The District Court of three judges found the order unauthorized by Texas law and enjoined enforcement. This Court said (page 499):

> "Had we or they no choice in the matter but to decide what is the law of the state, we should hesitate long before rejecting their forecast of Texas law. But no matter how seasoned the judgment it cannot escape being a forecast rather than a determination."

And again at page 500:

> "Few public interests have a higher claim upon the discretion of a federal chancellor than the avoidance of needless friction with the state policies * * *. (Citing cases.) These cases reflect a doctrine of abstention appropriate to our federal system whereby the federal courts 'exercising a wise discretion,' restrain their authority because of 'scrupulous regard for the rightful independence of the state Governments' and for the smooth working of the federal judiciary. See *Cavanaugh* vs. *Looney,* 248 U. S. 453, 457; *DiGiovanni* vs. *Camden Fire Ins. Asso.,* 296 U. S. 64. This use of equitable powers is a contribution of the courts in furthering the harmonious relation between state and federal authority without the need of rigorous congressional restriction of those powers."

The cause was remanded to the District Court with directions to retain the bill pending a determination of proceedings to be brought with reasonable promptness in the State Court.

Again there was no abandonment or ceding of jurisdiction. This Court did not discuss the question whether the Federal Courts could not have asserted the power, if it has so seen fit, to determine any questions of local law in the Federal Court just as such questions were determined by the lower court. The rule did not develop out of any lack of power, if this Court had seen fit to assert such power, but out of the propriety of asserting such power under the special circumstances of that case. *Thompson* vs. *Magnolia Petroleum Co., supra,* was cited by this Court in the *Pullman* case.

Chicago vs. *Fieldcrest Dairies,* 316 U. S. 168.

This case involved (1) the interpretation of a city ordinance, (2) whether under a certain interpretation the ordinance was in conflict with a State act, and (3) whether if applicable the ordinance was violative of the Federal Constitution. The important question was not, as has been stated, the Federal constitutional question. At page 172 this Court stated:

> "Furthermore, the dispute in its broad reach involves a question as to whether a city has trespassed on the domain of a state."

That the constitutional question was merely incidental is clearly shown on page 173 wherein this Court said:

> "It is of course true that respondent sought to raise in its complaint a constitutional issue—an issue which lurks in the case even though it not be deemed substantial. But here as in the *Pullman Co.* case, that issue

> may not survive the litigation in the state courts. If it does not, the litigation is at an end. *That again indicates the wisdom of allowing the local law issues first to be resolved by those who have the final say.* Avoidance of constitutional adjudications where not absolutely necessary is part of the wisdom of the doctrine of the *Pullman Co.* case."

After citing the *Pullman* case at length this Court went on to say (page 172):

> "In this case that discretion calls for a remission of the parties to the State Court which alone can give a definite answer to the major questions posed. Plainly they constituted the more appropriate forum for the trial of those issues."

An analysis of this case shows clearly that the Court was concerned with a rule that had developed because of the propriety of pursuing a certain course in order to avoid unnecessary conflict with State governmental agencies. This Court clearly disclosed its purpose when it said (page 172):

> "Considerations of delay, inconvenience, and cost to the parties which have been urged upon us, do not call for a different result. For we are here concerned with the much larger issue as to the appropriate relationship between federal and state authorities functioning as a harmonious whole."

This Court unmistakably disclosed that the basic question is the propriety of pursuing a certain course under a given set of facts by stating at page 171:

> "We granted the petition for certiorari because of the doubtful propriety of the District Court and of the

> Circuit Court of Appeals in undertaking to decide such an important question of Illinois law instead of remitting the parties to the state courts for litigation of the state questions involved in the case."

This Court reversed the lower courts for undertaking such a questionable determination. There was no choice of alternatives under the special circumstances of that case. The District Court was required to remit the parties to the State Courts for the authoritative determination of the questions of local law. Failure to do so constituted reversible error.

Spector Motor Service vs. *McLaughlin*, 323 U. S. 101.

This case arose out of a suit brought in the United States District Court to enjoin the enforcement of a State tax. The District Court held the State tax inapplicable to the *Spector Motor Service*. The Second Circuit reversed the District Court holding that the tax was applicable and valid. This Court said at page 105:

> "If there is one doctrine more deeply rooted than any other in the process of constitutional adjudication, it is that we ought not to pass on questions of constitutionality—here the distribution of the taxing power as between the State and the Nation—unless such adjudication is unavoidable. And so, as questions of federal constitutional power have become more and more intertwined with preliminary doubts about local law, we have insisted that federal courts do not decide questions of constitutionality on the basis of preliminary guesses regarding local law."

The State has been informed that this Court of its own motion referred the matter back to the District Court with instructions to hold the litigation in the Federal Courts

until definite determinations on local law had been made by the State Courts. Again there was no question of discretion under the facts of the instant case. There was no choice of alternatives. The District Court was required as a matter of law to pursue a certain and definite course because of the special circumstances of the case. There was no abandonment or ceding of jurisdiction. That jurisdiction remained in the Federal courts completely and inviolate. This Court simply determined that the hand of the Federal Court should be stayed until such time as such Court could receive the aid of the State Courts and obtain an authoritative determination on questions of local law and so avoid the necessity of having the Federal Courts make decisions that at best would only be preliminary guesses regarding the said local law.

The State also cited *In re Central Railroad Co.*, 136 F. (2d) 633. This case was cited with approval by this Court in the just mentioned *Spector Motor* case. In that case the Third Circuit said at page 638:

> "In recent years the Supreme Court has ruled that though a Federal Court may have jurisdiction to pass upon the meaning and effect to be given a state statute it is, in the exercise of a wise discretion, appropriate for it to stay its hands in the absence of a showing that the remedy sought is not readily obtainable in the State courts which are the final arbiters of the question."

Other cases holding to the same effect are *Mangus* vs. *Miller*, 317 U. S. 178, 186; *Alabama State Federation of Labor* vs. *McAdory*, 325 U. S. 450, 471; and *American Federation of Labor* vs. *Watson*, 327 U. S. 582. The last men-

tioned case involved the construction of a 1944 amendment to the Florida Constitution. Again the cause was retained by a three judge court and all questions were decided by that court. This court reversed the judgment holding that the cause should have been retained by the District Court pending an authoritative interpretation of the Florida law by the State Court.

There is no doubt that, if years ago this Court had desired to adopt a different attitude and to assert the maximum of jurisdiction in the Federal courts and totally ignore the State courts, the rule could have been established otherwise than it is. It could have been held that, once a Federal Court has acquired jurisdiction, all questions shall be answered by the said Federal Court, including all questions of local law. But a rare wisdom has controlled the thinking of this Court with respect to this quite troublesome problem. This Court has developed the rule, the equitable principle, that, when the special circumstances warrant it, certain questions of local law must, as a matter of law, be referred to the State Court for authoritative determination. The ruling was dictated by the understandable desire to preserve the rightful independence of the State Governments, to avoid needless friction with State policies and to maintain an appropriate relationship between Federal and State authorities functioning as a harmonious whole. This equitable principle does not allow for a choice of alternatives. There is only one course open to the Federal Court. It must call to its aid the resources of the State Courts for the purpose of having an authoritative determination on questions of local law. There is no abandonment of jurisdiction. The procedure is in aid of that jurisdiction.

Meredith vs. *Winter Haven,* 320 U. S. 228, does not state a different rule. The Court had jurisdiction in that case on account of diversity of citizenship. In the course of the controversy an important question of local law arose. The District Court assumed jurisdiction and answered the

local question. This judgment was reversed by the Fifth Circuit which ordered that the bill be dismissed without prejudice. The only question involved was the said question of local law. The Court did not attempt to follow the pattern of the several cases above mentioned, in each of which cases jurisdiction was retained while the question of local law was referred to the State court for the determination. This Court by a divided vote held that the bill was properly maintainable by the District Court and that the local question should have been decided in that Court. The *Meredith* case did not present those special circumstances which dictated the application of the above-mentioned equitable rule in the cited cases. Had this Court held otherwise than it did, then there would have been authority whereby in every diversity of citizenship case the jurisdiction of the District Court could be denied if some undecided question of local law should be raised.

This Court said in the *Meredith* case at page 234:

> "*In the absence of some recognized public policy or defined principle* guiding the exercise of the jurisdiction conferred, which would in exceptional cases warrant its non-exercise, it has from the first been deemed to be the duty of the federal courts, if their jurisdiction is properly invoked, to decide questions of state law whenever necessary to the rendition of a judgment."

And at page 237:

> "Decision here does not require the federal court to determine or shape state policy governing administrative agencies. It entails no interferences with such agencies or with the state courts. No litigation is pending in the state courts in which the questions here presented could be decided. *We are pointed to no public policy or interest* which would be served by withholding from petitioners the benefit of the jurisdiction which

> Congress has created with the purpose that it should be availed of and exercised subject only to such limitations as traditionally justify courts in declining to exercise the jurisdiction which they possess."

This Court cited a large number of cases wherein the facts constituted the special circumstances which required the operation of the equitable principle developed by the rule of the cases set forth at length above. That such cases were mentioned as examples and not by way of limitation is disclosed by the statement of the Court at page 236:

> "But none of these questions, nor any similar one, is present here."

But no enlargement of the rule is necessary. The State believes that the special circumstances of the instant case bring the said case within the rule established by the four named cases. The State respectfully submits that the controlling decisions of this Court require that the questions of local law, presented by the Trustee's petition of August 12th, 1944, should be referred to the State courts for authoritative determination.

B. The Special Circumstances.

The State relies upon the following special circumstances to bring the instant case within the rule of the above-mentioned cases. The said circumstances may be summarized as follows: (1) The existence of an outstanding State Court decree clearly intended to affect the present claim; (2) the past action of the Federal Courts with respect to the Settlement Acts; (3) the elimination of the necessity of answering certain Federal Constitutional questions if the State Court decides the local questions favorably to the Trustee; (4) the like elimination of the necessity of answering certain bankruptcy questions; and (5) the

confusion and ultimate delay that may be caused by retaining the local questions in the Bankruptcy Court. The said circumstances will be considered in the order named.

1. *The Bankruptcy Court should not undertake to answer a question of local law which may be answered in such manner as to be in conflict with the existing decree in* *Wilentz* vs. *Hendrickson, supra.*

We are not here concerned with the question of whether as a matter of law the existing decree of the Court of Chancery of New Jersey is binding upon the Federal Courts. We are here concerned solely with the propriety of having the Bankruptcy Court undertake to make a decision which, if contrary to the finding of the New Jersey Courts in *Wilentz* vs. *Hendrickson, supra,* might cause unseemly conflict.

This Court in *Chicago* vs. *Fieldcrest Dairies, supra,* determined as a matter of law that certain questions of local law should be referred to the State Court for determination because of an appropriate regard for the rightful independence of State governments, in order to avoid needless friction with State policies and in order to preserve the appropriate relationship between Federal and State authorities functioning as a harmonious whole.

It would appear that, if it was improper for the United States District Court to undertake to determine whether or not a city ordinance was in conflict with a State statute as in the *Fieldcrest* case, most certainly any consideration of the question of the applicability of the Settlement Acts by the Bankruptcy Court would constitute an unseemly interference with State government and be contrary to that appropriate relationship between Federal and State authorities functioning as a harmonious whole, so long as the existing decree of the New Jersey Court of Chancery, preventing the requisite performance under the Settlement Acts, remains unmodified.

2. *The fact that the Bankruptcy Court has heretofore attempted to adjudicate concerning the applicability of the Settlement Acts in spite of the temporary restraining order of the New Jersey Court of Chancery is a special circumstance that should cause the Federal Courts to stay its hand now that the restraining order has become permanent.*

In this subsection we are concerned not so much with the final decree itself as we are with the conduct of the Federal Courts during the time that the cause, which led to the entry of the final decree, was being determined.

Very shortly after the passage of the second Settlement Act, the Bankruptcy Court entered its order No. 163 determining the claim of the State to be allowable in the amount provided by the said Settlement Acts. The said Court in effect held the said Acts to be applicable to the Debtor, notwithstanding the entry of the temporary restraining order of the New Jersey Court of Chancery. The State appealed such order. The Third Circuit in reversing the said order had before it substantially the same arguments now being urged before this Court. The Third Circuit determined that, in the exercise of a nice discretion, the Bankruptcy Court should have held the matter pending the determination of the State Courts in *Wilentz* vs. *Hendrickson, supra.* (*In re Central Railroad Co.*, 136 F. (2d) 633.) In that case Judge Maris made the observation for the Court with respect to the tender of payment under the Settlement Acts set forth above at page 5.

It is hardly conceivable that, having waited the determination by the State Court and such determination being that the Settlement Acts are unconstitutional, this Court would permit the Bankruptcy Court to entertain an action which has the purpose of arriving at a different determination than that already made by the State Courts. Certainly "the delicacy of that issue and an appropriate regard 'for the rightful independence of the State governments' re-

emphasizes that it is a wise and permissible policy for the federal chancellor to stay his hand in the absence of an authoritative and controlling determination by the State tribunals." *Chicago* vs. *Fieldcrest Dairies, supra.* The rule of the Pullman case that "the resources of equity are equal to an adjustment that will avoid the waste of a tentative decision" and any "needless friction with state policies," should certainly apply in a case where the Federal Court has stayed its hand with full knowledge of the State Court proceedings and has now had the benefit of the view of the said State Courts as a result of that proceeding.

An appropriate regard for the rightful independence of State governments, the avoidance of needless friction with State policies, and due regard for the appropriate relationship between the Federal and State authorities functioning as a harmonious whole require that the Bankruptcy Court do not undertake the consideration of any question that might be answered contrary to the decision in *Wilentz* vs. *Hendrickson, supra,* for the reason that the Bankruptcy Court was stayed in *In re Central Railroad Company,* 136 Fed. (2d) 633, for the purpose of awaiting the decision in the State Court in that particular case. The State respectfully submits that it would be unseemly at this time to give even the appearance of ignoring the very determination for which the Federal Courts had waited.

3. *Certain Federal Constitutional questions will not survive the litigation in the State Courts if the said State Courts decide the local questions favorably to the Debtor.*

In the Trustees' objections to the proof of claim of the State (App. 87a, 89a, 95a), there are set forth certain Federal Constitutional objections. At page 586a of the appendix to the Trustee's brief will be found certain Federal Constitutional objections to the State's claim urged by the

Institutional Group of Bondholders and the Trustee under the Debtor's general mortgage. Paragraph 2 sets forth one such objection, similar to the type of objection to be found in the Trustee's objections. The State believes that the issue presented by such objections was completely disposed of by *Gardner* vs. *New Jersey, supra.*

Nevertheless at page 45 of the brief filed below by the said Institutional Group and Trustee under the debtor's general mortgage will be found a reassertion of the same objections. In the words of Mr. Justice Douglas in the *Fieldcrest* case there does exist a Federal Constitutional issue—"an issue which lurks in the case even though it not be deemed substantial."

There is also to be found at page 587A, paragraph 3, another Federal Constitutional objection which has not been answered by the said *Gardner* case. It would appear, therefore, that the doctrine of *Spector Motor Service* vs. *McLaughlin* does apply in this case and constitutes another reason why the questions of local law should be referred to the State Courts for authoritative determination.

As was said in the *Fieldcrest* case, the Federal constitutional issue

> "may not survive the litigation in the State courts. If it does not, the litigation is at an end. That again indicates the wisdom of allowing the local law issues first to be resolved by those who have the final say. Avoidance of constitutional adjudications where not absolutely necessary is part of the wisdom of the doctrine of the Pullman Company case." (Page 173.)

And so in this case, it cannot be denied that if the State Court should determine the questions of local law favorably to the Debtor, the Federal Constitutional questions will all disappear. They will not survive the litigation in the State Court.

4. *It will be unnecessary to determine certain disputed bankruptcy questions if the State court should determine questions of local law favorably to the Trustees.*

This Court in *Gardner* vs. *New Jersey, supra,* set forth at page 579 et seq., certain bankruptcy questions that may remain to be answered in the bankruptcy proceedings. Among those are the question of the amount of interest that has accrued prior to bankruptcy and the question of the liability of the Trustee for interest that has accrued subsequent to the institution of the Section 77 proceedings.

If it should be determined that there was a contract consummated with the State pursuant to the terms of the Settlement Acts or that in some other manner the said Acts are available to the Debtor or the Trustee as a matter of local law, then it will be unnecessary to answer any of those questions. There will be no interest due prior to bankruptcy because the Legislature sought to forgive all of such interest. The only interest for which the Debtor would have been liable is the three per cent (3%) subsequent to 1940, the payment of which forms a part of the terms for compliance with the said Settlement Acts, and which amount the Trustee asserts that he has paid. Thus no further bankruptcy questions will remain.

This Court held in the *Spector Motor Service* case that:

> "as questions of federal constitutional power have become more and more intertwined with preliminary doubts about local law, we have insisted that Federal Courts do not decide questions of constitutionality on the basis of preliminary guesses regarding local law."

There can be no substantial distinction between the propriety of referring questions of local law to State Courts in order to eliminate the necessity of answering Federal Constitutional questions which may not survive the litiga-

tion in the State Courts and the propriety of referring such questions of local law to State Courts in order to eliminate the necessity of answering Federal Bankruptcy questions which likewise may not survive such litigation. Where as in the instant case, the answer to the questions of local law, favorably to the Debtor, will determine the whole controversy—where the Federal bankruptcy issues "may not survive the litigation in the State Courts"—the State respectfully submits that the very same rule should apply and questions of local law should be referred to the State Court for authoritative determination.

This is another special circumstance which brings the instant case within the intent of the equitable principles set forth above.

5. *Were the Federal Court to undertake to answer the questions of local law, confusion and ultimate delay might ensue.*

In addition to the fact that a favorable decision for the Trustees would eliminate the necessity of answering federal bankruptcy questions, there is the additional argument that, if the Bankruptcy Court does go forward and answer both the Federal and local questions in one proceeding, a great amount of confusion might result and instead of expediting the determinations of the matter, additional delay might be caused. The Court below recognized this in its opinion (C. C. A. Rec., page 42).

Let us assume that the Bankruptcy Court answers the local question favorably to the Debtor and holds that no additional amount of taxes is due. The Bankruptcy Court would not then go on to answer the several bankruptcy questions, set forth in the opinion of Mr. Justice Douglas in the *Gardner* case, in anticipation of the contingency that the Third Circuit or this Court might reverse. It may not be denied that the Federal Courts could hold (1) that the Bank-

ruptcy Court had no right to ignore the decree in *Wilentz* vs. *Hendrickson,* (2) that the Bankruptcy Court had no basis for believing that the law might be different if presented in a different case, and (3) that with the existing injunction there was no possible chance to comply with the terms of the Settlement Acts. In such an eventuality the cause would have to go back to the Bankruptcy Courts to have the question of bankruptcy law determined by that court. Obviously the time spent would be a total loss.

The State confidently believes that, if a record came up in any such condition, this Court would hold that the Bankruptcy Court had failed to recognize the equitable principle developed by the rules of the *Magnolia Petroleum Co.* case, the *Pullman Company* case, and the *Fieldcrest* case. We respectfully submit that this Court would hold that, in the exercise of a nice discretion, in consideration of the rightful independence of State governments, because of the necessity of avoiding needless friction with State policies and because of an appreciation of that appropriate relationship between Federal and State authorities functioning as a harmonious whole, questions of local law under the special circumstances of this case must be referred to State Courts for authoritative determination.

There are other contingencies which would cause confusion and delay similar to the example just given. The State will not set those forth in detail at this time. The State does urge however that there are other possible results that might cause great confusion and eventually lead to greater delay than that which will ensue if the local questions are referred to the State Court at this time. As we have pointed out above, the learned Judge below fully recognized the dangers of delay attendant upon any attempt to determine the local questions in the Bankruptcy Court. Thus in this case there is no need to invoke the rule of the *Fieldcrest* case set forth at page 22 above with respect to considerations of delay and inconvenience. Even greater delay might ensue if the local questions are not referred.

The State respectfully urges that this constitutes a further special circumstance requiring the application of the equitable principle set forth above.

In conclusion of this point, the State respectfully submits that there has developed by reason of the decisions of this Court an equitable principle which requires that, where the special circumstances exist, questions of local law should not be answered by the Federal Courts but instead such questions should be referred to the State Court for authoritative determination, the Federal Court meanwhile holding the cause pending such determination. The rule has developed out of the equitable principle that "it is an exercise of a 'sound discretion, which guides the determination of courts of equity.' " The discretion meant is not the discretion to choose one of two alternatives in a given case. It is the broad discretion which reposes in the Federal Chancellor, carrying with it a solemn obligation. When the special circumstances appear, the Federal Court can choose but one course. Failure to pursue that course constitutes error in law.

The State respectfully submits that the instant case presents the special circumstances required by the controlling cases and that the Court below properly determined that the Bankruptcy Court should hold the cause pending a determination by the State Court of the disputed questions of State law. In view of such controlling cases, the Third Circuit properly held that the questions of local law presented by the petition of August 12th, 1944, should be referred to the State Court for authoritative determination.

CONCLUSION.

It is respectfully submitted that this case involves no matter properly warranting the granting by this Court of the discretionary remedy of review by certiorari and that the prayer for the issuance of the writ of certiorari should be denied.

Respectfully submitted,

WALTER D. VAN RIPER,
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Attorney for the State of New Jersey, Respondent.

BENJAMIN C. VAN TINE,
Of Counsel.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1947.

No. 349.

WALTER P. GARDNER, Trustee of The Central Railroad Company of New Jersey,
A Debtor-Petitioner,

vs.

THE STATE OF NEW JERSEY,
A Creditor.

BRIEF OF CITY OF JERSEY CITY, *AMICUS CURIAE*, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

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IN THE

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WALTER P. GARDNER, Trustee of The Central Railroad Company of New Jersey,
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vs.

THE STATE OF NEW JERSEY,
A Creditor.

BRIEF OF CITY OF JERSEY CITY, *AMICUS CURIAE*, IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

Status of *Amicus Curiae*.

The City of Jersey City files this brief as *amicus curiae*, since it has an interest of approximately 30% as statutory distributee in the tax claim of the State of New Jersey against the debtor and trustee.

Statement of the Case.

A statement of a substantial portion of the facts material to this application is to be found in *Gardner* v. *New Jersey*, 329 U. S. 565, at pages 568-572, 584.

In summary, the situation is as follows:

The State of New Jersey asserts a claim of lien against the estate of the debtor for delinquent taxes and statutory interest accrued thereon for the tax years 1932 to 1940, inclusive, subject to credits of certain payments which have been made during the reorganization proceedings. The trustee and the bondholders of the debtor have filed a number of objections to the claim of the state, both in respect of the total amount involved and as to the priority and existence of the lien as to the statutory interest part of the claim. Of these objections, one, that based upon the effect of the enactment by the New Jersey legislature of the "Railroad Tax Settlement Acts" of 1941-1942 (Chap. 290 of the Laws of 1941, and Chap. 241 of the Laws of 1942), and events subsequent thereto, would make it unnecessary, if sustained, to consider any of the others. The latter objections to the taxes and the assertion of lien are based partly upon the United States Constitution and partly upon the Bankruptcy Act. Those that relate to the Constiution will be detailed hereinafter.

The Railroad Tax Settlement Acts had the purported effect of permitting the payment of accrued principal tax arrears of various railroads, including the debtor, in installments over a period of years, and of abating in entirety statutory interest. The trustees of the debtor attempted to comply with the Settlement Acts, but an action instituted in the Court of Chancery by the New Jersey Attorney General and his refusal to approve the settlement papers prevented any of the necessary state officials from accepting the tenders of payments and documents made by the trustees, and such litigation finally eventuated in an adjudica-

tion by the New Jersey Court of Chancery, affirmed by the New Jersey Court of Errors and Appeals, that the Settlement Acts were null and void as in contravention of the New Jersey Constitution, and enjoining the effectuation thereof by any New Jersey official. *Wilentz* v. *Hendrickson,* 133 N. J. Eq. 447, 33 Atl. (2d) 366; affirmed 135 N. J. Eq. 244, 38 Atl. (2d) 199.

Subsequently, the trustees and the bondholders formally restated the basis of their objections to the New Jersey claim, first, in a petition of the trustees requesting an adjudication concerning the claim (p. 47a), and then in Supplemental and Amended Objections and Defenses to the Claim (pp. 94a; 586a). The Supplemental and Amended Objections and Defenses are first, that the claim "exceeds" by a stated figure "the maximum amount which the State of New Jersey may lawfully claim to be due under or by virtue of its statutes, viz., Chap. 290 of the Laws of 1941, and Chap. 241 of the Laws of 1942, with which Statutes the undersigned Trustees of the Debtor have duly complied pursuant to the orders of this Bankruptcy Court" (p. 94a, par. 1; p. 586a, par. 1), and "Alternatively" (p. 95a, par. 5; p. 586a, par. 2), that if the first objection, that based upon the Settlement Acts, is denied, the claims and the lien asserted are objectionable on the basis of various federal constitutional and federal bankruptcy statutory provisions.

The present application is for a review of a judgment of the Circuit Court of Appeals reversing Order No. 260 of the Bankruptcy Court which denied an application of the Attorney General of New Jersey for permission to submit to the courts of New Jersey for adjudication the state law and state constitutional questions involved in the major

defense of the trustees and bondholders to the tax claim, that based upon the effects and consequences of the enactment of the Railroad Tax Settlement Acts. The questions sought to be referred to the state courts were framed by the Attorney General in his petition (p. 135a; par. 1 on p. 136a), in the language of the prayer of the petition of the trustees to the Bankruptcy Court for adjudication concerning the claims (p. 71a, prayers No. 1 and 2), *i. e.*, whether the trustees had entered into a contract with the State of New Jersey (pursuant to the Settlement Acts), and whether such contract is binding on the parties thereto. The Bankruptcy Court denied the Attorney General's petition, holding that the determination of these questions should remain with the Bankruptcy Court (p. 217a), and the Circuit Court of Appeals reversed (Tr., p. 50), holding that the stated questions should be determined in the state courts. The opinion of the Circuit Court describes the issue to be referred to the state courts thus: "The basic problem of whether there is a contract between the debtor and the State of New Jersey" (Tr., p. 42).

ARGUMENT.

I.

Certiorari should be denied because the action directed by the Circuit Court of Appeals is that required by recent applicable decisions of this Court.

We submit that regardless of the reasoning in the opinion of the Circuit Court of Appeals by which it reached the

result of reversal, the judgment was one which this Court would concur in on the basis of its own recent applicable rulings, and that therefore certiorari should be denied as accomplishing no useful purpose, but only such further delay as this reorganization can ill afford. The rules which required the result directed by the judgment below are these:

(a) Where a federal court is confronted with uncertain questions both of state law and of federal constitutional law, and the latter may be obviated by an authoritative state court determination of the local law questions, the federal court will refer the latter to the state courts for determination. *American Federation of Labor* v. *Watson*, 327 U. S. 582; *Spector Motor Service, Inc.* v. *McLaughlin*, 323 U. S. 101; *Chicago* v. *Fieldcrest Dairies*, 316 U. S. 168; *Railroad Commission of Texas* v. *Pullman Co.*, 312 U. S. 496; and see *Alabama State Federation of Labor* v. *McAdory*, 325 U. S. 450, 470.

(b) The federal courts should refer state law questions to the state courts for determination wherever such a factual situation exists as makes that course conduce to "the appropriate relationship between federal and state authorities functioning as a harmonious whole." *Chicago* v. *Fieldcrest Dairies, supra* (316 U. S. at p. 173); *Railroad Commission* v. *Pullman Co., supra*, (312 U. S. at pp. 500, 501); *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478.

The application of each of these rules to the situation involved below is plain.

1. As to the potential elimination of federal constitutional questions:

As we have indicated above, the trustee and the bondholders rely in objection to the asserted tax liens primarily upon the Tax Settlement Acts. If it is held that they are entitled to the benefit of these acts, the claim of the state is either eliminated or very substantially reduced. The trustee and all of the bondholders have expressed unqualified acceptance of the Tax Settlement Acts. If they are held applicable, the trustee and the bondholders have expressed complete willingness to make payment from the estate of the debtor to New Jersey of whatever is required thereby, and every single alternative objection based either upon the federal constitution or the bankruptcy law is eliminated from the case. The subsidiary questions of state law within the general question as to the existence of a binding contract between the debtor and trustee, and New Jersey, which the Attorney General will submit to the state courts pursuant to his application now ordered granted by the Circuit Court of Appeals, are these:

(a) Are the Tax Settlement Acts offensive to the New Jersey Constitution in their application to the debtor? (This will involve testing the acts, not only by Article I, Section 20, of the New Jersey Constitution, which they were held to violate in *Wilentz* v. *Hendrickson, supra,* but also by Article IV, Section 7, Paragraph 11, prohibiting special laws granting privileges and immunities, a question which was raised by the Attorney General in *Wilentz* v. *Hendrckson,* but found unnecessary for determination by the court in that case. See 133 N. J. Eq. 447, 463. This latter constitutional deficiency of the Tax Settlement Acts is

also asserted by the Attorney General in the present proceeding (p. 108a, pars. 12, 13).

(b) Assuming the acts do contravene either or both of the New Jersey constitutional provisions referred to, does the attempted compliance by the trustee with said acts prior to the declaration of their unconstitutionality by the New Jersey courts, have the effect, under New Jersey law, of binding the state by contract under said acts?

While we have no doubt but that the latter issue would be determined against the trustee on the basis of such New Jersey cases as *Hyman* v. *Long Branch Kennel Club, Inc.*, 115 N. J. L. 123 and *Eastwood* v. *Russell*, 81 N. J. L. 672, the trustee supports his position as to that issue by reliance upon such cases as *Lang* v. *Bayonne*, 74 N. J. L. 455, 459. This Court, in *Gardner* v. *New Jersey, supra*, referred to both of the foregoing issues as "questions of local law" involved herein (329 U. S. at p. 583). If *either* of the foregoing local law questions are determined by the state courts in favor of the trustee, the following seriously asserted *questions of federal constitutional law*, formally raised by the trustee and bondholders as alternative objections to the state's tax and lien claims, *are rendered entirely unnecessary of determination:*

(1) The New Jersey assessments were discriminatory in that they were at or in excess of true value, while non-railroad property was assessed at less than true value or exempted, thereby violating the equal protection clause of the Fourteenth Amendment (p. 87a, par. (h)).

(2) The underassessment of non-railroad property throughout the State resulted in an inflated "average tax

rate" which, when applied by statute to valuations of railroad property, constituted a denial of due process and of the equal protection of the laws under the Fourteenth Amendment (p. 87a, par. (i)).

(3) Assessments of debtor's property, being in excess of true value, constitute an interference with and a burden upon interstate commerce in violation of Article I, Section 8, of the Constitution (p. 89a, par. (l)).

(4) The assessments of debtor's property, being in excess of true value, constitute an interference with the exercise by Congress of its bankruptcy powers in violation of Article I, Section 8, Paragraph 4, of the Constitution (p. 89a, par. (m)).

The foregoing objections were first set forth in the original objections to the State's proof of claim. They are incorporated by reference in the "Supplemental and Amended Objections and Defenses, etc." of the trustees as alternative to the defense based upon the Settlement Acts (p. 95a, par. 5).

(5) The Settlement Act contract was a valid one under the law of New Jersey prior to the decision in *Wilentz* v. *Hendrickson,* and the latter ruling, if held applicable to the debtor's estate, would constitute an invalid impairment by judicial decision of a contract valid when made (p. 69a, par. 29). This is apparently an invocation of the rule in *Ohio Life Ins. & Trust Co.* v. *Bedolt,* 16 How. (U. S.) 416, 432, construing the obligation of contract clause of the United States Constitution, Article I, Section 10.

(6) The assertion by the State of New Jersey of a lien for that part of the tax claim consisting of interest

would result in the impairment of contract rights of the bondholders and deprive them of their property without due process of law, contrary to the Fourteenth Amendment, for the asserted reason that the law of New Jersey made no provision for a lien in respect of statutory interest on delinquent taxes at the time of the execution and delivery of the debtor's general mortgage (pp. 586a, 587a, par. 3).

It is true that by virtue of the decision of this Court in *Gardner* v. *State of New Jersey, supra,* the trustee is precluded from seeking a revaluation of debtor's properties, as a matter of bankruptcy power to determine the question of value. For that reason the constitutional objections listed in paragraph 4 are eliminated from this proceeding. This may also be true of the objections in paragraphs 1 and 3, though possibly not, since the valuations are questioned not merely as violations of state law, but as infringements of federal constitutional rights. Cf. *Hillsborough* v. *Cromwell,* 326 U. S. 620. But the objections noted in paragraphs 2, 5 and 6, *supra,* are clearly subsisting before the reorganization court and in no way affected by the case of *Arkansas Corporation Commission* v. *Thompson,* 313 U. S. 132.*

None of these federal constitutional questions would require determination in the event that the New Jersey courts, on the requested reference, determine that the Settlement Acts are valid as to the trustee or that a binding contract has arisen settling the amount of the tax claim against the debtor.

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* This is not to be taken as a concession of the validity of those objections as we are confident that they will be found untenable as a matter of law on the basis of other authorities, when and if their adjudication is called for by the reorganization court.

Both the majority and minority opinions in the Circuit Court of Appeals concluded that the doctrine of the *Spector Motor Service, Inc.* case, *supra,* was inapplicable here for the reason that in that case the state statute involved had not been previously construed (Tr., pp. 33, 45). We respectfully dissent from that asserted distinction. The determinative feature of the *Spector Motor Service, Inc.* and other cases cited hereinabove under that line of decision is that a federal court will not undertake determinations of federal constitutional law based upon its own preliminary conclusions with respect to uncertain matters of state law, but will refer the latter to the state courts so that the necessity for the decision of the federal constitutional questions will be made certain by an authoritative and binding state court decision of the state law questions. Under the rationale of that rule it does not make any difference whether the state law question is the meaning of a statute as yet unconstrued, or the determination of any other question of state law. The federal courts are just as apt to make an incorrect forecast of the ultimate decision of the highest state court upon a matter of state law in respect to which there are existing decisions in a state of conflict, or of uncertain application to a new situation, as when dealing with an ambiguous statute not yet construed. If, as has been conceded by the Attorney General for purposes of the application to the Bankruptcy Court denied by it, there is any debatable issue as to whether Article I, Paragraph 20, or Article IV, Section 7, Paragraph 11, of the New Jersey Constitution invalidate the Tax Settlement Acts as to the railroad debtor, the Bankruptcy Court is faced with the problem of making such a determination as a condition precedent for its entry into the federal constitutional inquiries

posed by the alternative objections to the state's tax claim noted above. Moreover, and in this respect the situation is within the precise holding, as well as the *ratio decidendi* of the *Spector Motor Service, Inc.*, case, in making a determination with respect to the constitutionality of the Tax Settlement Acts as special legislation under Article IV, Section 7, Paragraph 11, of the New Jersey Constitution, the Bankruptcy Court would be considering an issue which has never been decided by any New Jersey Court. (See *supra*, p. 6.)

The language of this Court in the *Spector* case is so perfectly dispositive of the issue here involved, that we quote its reasoning at length (323 U. S. at pp. 104, 105):

> "* * * it is for Connecticut to decide from what aspect of interstate business she seeks an exaction. It is for her to say what is the subject matter which she sought to tax and what is the calculus of the tax she seeks. *Every one of these questions must be answered before we reach the constitutional issues which divided the court below.*
>
> "Answers to all these questions must precede consideration of the Commerce Clause. To none have we an authoritative answer. Nor can we give one. *Only the Supreme Court of Errors of Connecticut can give such an answer.* But this tax has not yet been considered or construed by the Connecticut courts. We have no authoritative pronouncements to guide us as to its nature and application. That the answers are not obvious is evidenced by the different conclusions as to the scope of the statute reached by the two lower courts. The Connecticut Supreme Court may disagree with the District Court and agree with the Circuit Court of Appeals as to the applicability of the statute. But this is an assumption and at best 'a forecast rather than a de-

termination.' *Railroad Commission* v. *Pullman Co.*, 312 U. S. 496, 499, 85 L. Ed. 971, 974, 61 S. Ct. 643. *Equally are we without power to pass definitely on the other claims urged under Articles 1 and 2 of the Connecticut Constitution.* If any should prevail, our constitutional issues would either fall or, in any event, may be formulated in an authoritative way very different from any speculative construction of how the Connecticut courts would view this law and its application. *Watson* v. *Buck*, 313 U. S. 387, 401, 402, 85 L. Ed. 1416, 1423, 1424, 61 S. Ct. 962, 136 A. L. R. 1426.

"If there is one doctrine more deeply rooted than any other in the process of constitutional adjudication, it is that we ought not to pass on questions of constitutionality—here the distribution of the taxing power as between the State and the Nation—unless such adjudication is unavoidable. And so, as questions of federal constitutional power have become more and more intertwined with preliminary doubts about local law, *we have insisted that federal courts do not decide questions of constitutionality on the basis of preliminary guesses regarding local law.* *Railroad Commission* v. *Pullman Co.*, 312 U. S. 496, 85 L. Ed. 971, 61 S. Ct. 643, *supra; Chicago* v. *Fieldcrest Dairies*, 316 U. S. 168, 86 L. Ed. 1355, 62 S. Ct. 986; *Re Central R. Co.*, (C. C. A. 3d) 136 F. (2d) 633, 54 Am. Bankr. Rep. (N. S.) 101. See also *Burford* v. *Sun Oil Co.*, 319 U. S. 315, 87 L. Ed. 1424, 63 S. Ct. 1098; *Meredith* v. *Winter Haven*, 320 U. S. 228, 235, 88 L. Ed. 9, 13, 64 S. Ct. 7; *Green* v. *Phillips Petroleum Co.*, (C. C. A. 8th) 119 F. (2d) 466; *Findley* v. *Odland*, (C. C. A. 6th) 127 F. (2d) 948; *United States* v. *150.29 Acres of Land More or Less*, (C. C. A. 7th) 135 F. (2d) 878. Avoidance of such guesswork, by holding the litigation in the federal courts until definite determinations on local law are made by the

state courts, merely heeds this time-honored canon of constitutional adjudication.

"We think this procedure should be followed in this case." (Italics supplied.)

In accord: *American Federation of Labor* v. *Watson, supra,* (327 U. S. at pp. 595-599); *Chicago* v. *Fieldcrest Dairies, supra,* (316 U. S. at p. 173); *Railroad Commission of Texas* v. *Pullman Co., supra,* (312 U. S. at pp. 499, 500, 501); cf. *Alabama State Federation of Labor* v. *McAdory, supra,* (325 U. S. at pp. 470, 471).

The magnitude and importance to all of the parties concerned of an expeditious determination, both of the reorganization as a whole and of the tax claim issue, makes it peculiarly important that the rule of the foregoing cases be followed in this case. Retention of the state law and state constitutional questions in the bankruptcy court promises possibilities of the greatest confusion and delay in the ultimate determination of the tax question because of the possibility of conflicting conclusions as to those matters by the district court, the Circuit Court of Appeals, and this Court, with the consequent wastage of considerable time, effort and money in the possible hearing and determination of unnecessary issues of both federal constitutional and federal bankruptcy law consequent upon erroneous determinations below of the state law and state constitutional questions.

There is one, and only one way of assuring that no needless inquiry into the alternative federal constitutional and federal bankruptcy issues will be undertaken in the bankruptcy court, and that is by procuring initially an authoritative and dispositive decision of the state law questions by the state courts, as will occur if the judgment of the Circuit Court of Appeals is not disturbed.

2. As to the preservation of "the appropriate relationship between federal and state authorities functioning as a harmonious whole."

If Order No. 260 had not been reversed by the Circuit Court of Appeals there would have been invited the possibility of a most unseemly collision and impasse between state and federal jurisdictions in a matter involving not merely the appropriate forum for the determination of a question of state law, but the settlement of a claim asserted by a sovereign state itself.

That such an impasse would arise is apparent from the following circumstances: The Settlement Acts require the payment of the full amount of principal tax arrearages for the years 1932-1940, together with interest at 3% per annum on all balances from and after December 1, 1940. P. L. 1942, Chap. 241, Sec. 4. Upon the basis of the most recent State claim in these proceedings, the total amount of principal and interest (3% per annum) which would be due from the debtor to the state *under the Settlement Acts* is $17,527,268.82.* Against this obligation, the debtor

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* This total is arrived at as follows:

Principal claimed from 1932-1939 (p. 107a, par. 9)	$14,140,887.53
Due from subsidiaries for same period (pp. 119a, 121a, 123a, 124a)	355,007.41
Unpaid principal for 1940 (p. 94a)	1,321,285.27
3% interest on balances from December 1, 1940 (see Exhibit "A" of "Petition of Trustee for order for instructions regarding the payment of taxes to the State of New Jersey", dated April 15, 1946, at page 296 of Tr. of R. in *Gardner* v. *State of New Jersey, supra)*	1,710,088.61
Total	$17,527,268.82

The difference between the $14,140,887.53 principal balance claimed by the State for 1932-1939, and the $12,117,383.92 (p. 94a, par. 2) computed by the debtor to be due for the years 1932-1939, is based upon the State's contention that previous partial payments on account by the debtor were legally appropriable to interest in advance of principal. Cf. *State* v. *Erie Railroad Co.*, 23 N. J. Misc. 203, 42 Atl. (2d) 759.

paid the State on May 6, 1946, pursuant to Order No. 333 in the reorganization proceedings, only $15,250,000 (Tr. of R., p. 318, in *Gardner* v. *State of New Jersey, supra*).

It thus appears that if the reorganization court undertakes to, and does, adjudicate that the Settlement Acts bind the State and that the obligation of the debtor to the State is computable upon that basis, and should the court further determine the local law question pertaining to the proper rule of appropriation of prior partial payments on account in favor of the position taken by the State, *an additional substantial balance will have to be ordered paid by the bankruptcy court to the State.* This is so, whether the rule of computation is determined to be the "United States" rule, on the basis of which the State's amended proof of claim has been computed, or the modified "United States" rule held to be applicable in *State* v. *Erie Railroad Co.*, 23 N. J. Misc. 203, 42 Atl. (2d) 759. *The tender of that balance would certainly be refused by the State Treasurer of New Jersey, since such tender would unquestionably and unequivocally be made pursuant to the Settlement Acts,* whereas *the final injunction* entered in *Wilentz* v. *Hendrickson, supra, permanently enjoins the State Treasurer from accepting any tenders of money under and pursuant to the Settlement Acts.* Not only under the Settlement Acts, but under the laws governing the duties and obligations of the State Treasurer generally, R. S. 52:18-1; *et seq.*, he is the only officer who can accept and transmit moneys into the State Treasury. He is, moreover, a constitutional officer (N. J. Const., Art. VII, Sec. 2, para. 2).

Notwithstanding such a decision by the federal courts the position of the officials of the State of New Jersey

might continue to be that the Settlement Acts were a nullity, since the final decree in *Wilentz* v. *Hendrickson* by the highest court of the State expressly held them so to be, not merely as against any particular railroad taxpayer, but absolutely and in entirety (p. 92a).

The sad spectacle of the conflict between federal and state authority which would result from such a determination by the reorganization court cannot be justified on the basis of any theoretical discussion by the trustee as to the supposed conclusiveness against the State of such a federal adjudication. Apart from the serious legal doubts attending such a conclusion, there would remain in any event a most regrettable disruption of the "appropriate relationship between federal and state authorities functioning as a harmonious whole." (*Chicago* v. *Fieldcrest Dairies, supra,* 316 U. S. at p. 173.)

But, as was stated by the United States Supreme Court in *Railroad Commission* v. *Pullman Co., Inc., supra,* (312 U. S. 496, at pp. 500-501), and reiterated in *Chicago* v. *Fieldcrest Dairies, supra,* (316 U. S. 168, at pp. 172, 173), " 'the resources of equity are equal to an adjustment that will avoid the waste of a tentative decision' and any 'needless friction with state policies.' " The indicated "adjustment" here is obviously by way of acceding to the request of the Attorney General and referring the state law and state constitutional questions to the state courts. Should they agree with the trustee that the Settlement Acts are valid as to the trustee and the debtor's estate, they could, and unquestionably would, modify the restraint against the State Treasurer which was entered in *Wilentz* v. *Hendrickson, supra,* so as to per-

mit the acceptance by that officer of any sum or sums adjudicated to be due from the estate of the debtor to the State in compliance with the Settlement Acts. Only in that way can this most vital issue raised in these proceedings be determined with authoritative finality and avoidance of needless friction between federal and state authorities and in consonance with the "appropriate relationship between federal and state authorities functioning as a harmonious whole."

> "Considerations of delay, inconvenience, and cost to the parties which have been urged upon us, do not call for a different result. For we are here concerned with *the much larger issue as to the appropriate relationship between federal and state authorities functioning as a harmonious whole.*" (*Chicago* v. *Fieldcrest Dairies, Inc.*, 316 U. S. at p. 173.)

That we are here confronted with a railroad reorganization under Section 77 does not affect the basic principle. The same disposition of a similar problem was made by the court in a Section 77 railroad reorganization case, *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478. And see the application of this principle in many general bankruptcy cases. *Ex parte Baldwin*, 291 U. S. 610, 619, cited by this Court in *Gardner* v. *State of New Jersey, supra,* (329 U. S. at p. 584), and the many cases cited in *Ex parte Baldwin, supra* (footnote on p. 619). The application of the rule is peculiarly apposite where the fiscal policies of the affairs of a state are involved. See the reference to "our historic national policy of federal non-interference with the taxing power of states," in *Arkansas Corporation Commission* v. *Thompson*, 313 U. S. 132, 145. Cf. the emphasis upon abstention of exercise of federal equity jurisdiction where

the "collection of state taxes or the fiscal affairs of the state" are involved. *Meredith* v. *Winter Haven,* 320 U. S. 228; *Matthews* v. *Rodgers,* 284 U. S. 525; *Great Lakes Dredge & Dock Co.* v. *Huffman,* 319 U. S. 293; *Stratton* v. *St. Louis S. W. R. Co.,* 284 U. S. 521.

II.

Response to statement by petitioner of the questions presented.

Petitioner formulates six "Questions Presented" at page 11 of his petition.

Questions 1 and 2 assume that the judgment of the Circuit Court of Appeals results in an abdication to the state courts by the bankruptcy court of its power to approve compromises of controversies arising in the administration of the estate of the debtor. This is plainly a misconception. The Attorney General in no way has questioned the right and authority of the bankruptcy court given by Section 27 of the Bankruptcy Act to approve the compromise of any controversy made by the trustee. The question which the Circuit Court has directed to be referred to the state courts merely submits for determination by the state courts the question as to whether the necessary second party to the compromise, the State of New Jersey, or its officers, possessed constitutional capacity to propose or consummate the compromise contained in the Settlement Acts, or whether any contract effectuating the compromise arose, under New Jersey law, notwithstanding unconstitutionality of the acts. The only function of the bankruptcy court

under Section 27 of the Bankruptcy Act is to approve the election of the trustee to become one of the parties to a proposed compromise. No question at all is raised by anyone as to the complete propriety under Section 27 of the action of the bankruptcy court and of the trustee in electing to become one of the parties to the proposed bilateral compromise agreement. What *is* involved is the issue as to whether the proposal of the legislature to make the State of New Jersey the other party thereto was offensive to the New Jersey Constitution, an issue which is one purely of state law in the highest degree and properly referable to state tribunals for adjudication for the reasons set forth above.

The third question framed by the petitioner is whether it is proper for the Circuit Court of Appeals to direct a bankruptcy trustee to submit one objection to the tax claim of a state to a state court and retain in the bankruptcy court "for later trial and decision other objections to the claim with inevitable, interminable and unnecessary delay in the reorganization of the debtor." This is a misstatement of the effect of the decision of the Circuit Court, since the reference of that "one" objection to the state court, that based upon the applicability of the Settlement Acts, may obviate the later trial and decision of all of the other objections to the claim, thus saving, rather than causing, "inevitable, interminable and unnecessary delay."

The purport of the fourth question presented is not at all clear. If the intent is to question the status, as matters of law, rather than of fact, of the issues referred to the state court involving the Settlement Acts, the best refutation is the express recognition by this Court in the *Gardner*

case, *supra*, that those questions are questions of local law (329 U. S. at p. 583).

The repetition of the same assertion in the fifth question, that the issue referred to the state court "was a mere issue of fact", plainly misapprehends what is involved in the directed reference. Three broad questions will require determination by the state court under the reference: (1) whether the Settlement Acts offend Article I, Paragraph 20, of the State Constitution in their application to the debtor; (2) whether the Settlement Acts offend Article IV, Section 7, Paragraph 11, of the New Jersey Constitution (prohibition of special legislation; see p. 6, *supra*); (3) whether, assuming the unconstitutionality of the Settlement Acts, the attempted compliance therewith by the debtor gave it vested rights under those acts under the authority of such New Jersey cases as *Lang* v. *Bayonne*, *supra*, notwithstanding the contrary rule laid down in *Hyman* v. *Long Branch Kennel Club*, *supra*, and the circumstances indicating absence of any completed accord because of the refusal of, and injunction against, the New Jersey officials required to act in acceptance of the tenders made pursuant to the Settlement Acts, so to do.

All of these questions are essentially questions of law and not of fact.

Even the assertion that the reference of the question as to constitutionality under Article I, Paragraph 20, involves only "a factual" issue as to the adequacy of certain considerations, is ill founded. As to this, the position of the Attorney General in *Wilentz* v. *Hendrickson*, *supra*, was primarily, that, viewed realistically, and stripped of forms and pretenses, the settlement legislation was, and was in-

tended by the legislature to be, a financial subsidy to the railroads of the state, and particularly to those in financial distress, on the theory that such financial assistance was necessary to foster railroad transportation and to rescue railroads from actual or threatened bankruptcy; that legislation of that character was precisely of the essence of the kind of legislation which it was the principal purpose of Article I, Paragraph 20, of the New Jersey Constitution, adopted as an amendment thereto in 1875, forever to prohibit. The Court of Chancery of New Jersey agreed precisely with this position, *Wilentz* v. *Hendrickson,* 133 N. J. Eq. at pages 474, 479-481, 484; 33 Atl. (2d) at pages 383, 386, 387, 388; and the Court of Errors and Appeals affirmed the decree in Chancery on the grounds stated in the Chancery opinion, as well as for other reasons contained in the opinion of that court.

As to the asserted "considerations" which were advanced on behalf of the State Treasurer to support the view that the legislative transaction was not donative, but contractual in character, the position of the Attorney General was that the legislative language, viewed against the background of the circumstances preceding and attending the adoption of the legislation, of which the court might take judicial notice, plainly showed that the asserted considerations were not intended by the legislature as bargain equivalents for the legislative grant, and that if they were, they were so slight, compared with the magnitude of the legislative remission, that the transaction as an entirety continued to retain the fundamental characteristics of a donation, rather than a contract. Again, we find presented an unadulterated issue of law. See *Wilentz* v. *Hen-*

drickson, 133 N. J. Eq. at pages 481-483, 33 Atl. (2d) at pages 387, 388; 135 N. J. Eq. at pages 257-260, 38 Atl. (2d) 207, 208.

Finally, the Attorney General contended that the unquestionably illegal "consideration" for the transaction (financial assistance for the purpose of promoting railroad transportation by privately operated companies) had the legal effect of vitiating the entire transaction, assuming any otherwise independently sufficient consideration. This contention was specifically concurred in by the Court of Chancery in *Wilentz* v. *Hendrickson,* 133 N. J. Eq. 447, 484, 33 Atl. (2d) page 388 [42] and, not having been disapproved by the Court of Errors and Appeals, was incorporated by reference in the opinion of that court. *Wilentz* v. *Hendrickson,* 135 N. J. Eq. 244, 261, 38 Atl. (2d) page 208 (last paragraph of majority opinion).

We submit that decision of the issues thus posed, which will again be squarely put forth in the present controversy whether the issues are decided by the courts of New Jersey or in the bankruptcy court, necessarily and inescapably involve the determination of strictly legal issues of construction of New Jersey legislation and of the New Jersey Constitution.

The sixth question framed by the petitioner is as follows:

> "6. Did not the Circuit Court err in holding that the Bankruptcy Court could not decide whether there had been a valid compromise of the State's claim on the ground that its decision could not be enforced without contravening a decree in the State Court against the State Treasurer?"

As to this, we submit that the Circuit Court did not hold that the bankruptcy court "could not" decide, but that it *ought not* to make such a decision in view of the continued pendency of the final injunction in the New Jersey courts. In any event, it is quite immaterial whether or not the Circuit Court of Appeals conceived that the bankruptcy court could not, as a matter of jurisdiction, decide the question involved. All that matters is *whether the judgment* of the Circuit Court of Appeals directing that the district court grant the application of the Attorney General for the state court reference, *violates or is in accord with the controlling rule* in a situation such as that here presented. We believe we have demonstrated under Point I hereinabove, that the judgment of the Circuit Court was not only not contrary to, but was affirmatively required by the rules in comparable situations laid down in recent years by this Court.

Nor should the issuance of a writ in this matter be controlled by differences of opinion as to whether the question below was one of discretion or one of law. If the problem in the bankruptcy court was one of discretion, it was a discretion subject to application in accordance with well settled rules, departure from which was appropriately subject to correction on review by the Circuit Court of Appeals. As was stated in *Franklin Life Insurance Co.* v. *Johnson,* 157 Fed. (2d) 653, 656 (C. C. A. 10th, 1946), "it is a judicial discretion, subject to review, and must be exercised in accordance with legal principles." A legal abuse of discretion consists of an "unreasonable departure from considered precedents, and settled judicial custom, which is error of law". *In re Horowitz,* 250 Fed. 106, 107 (C. C. A. 2d, 1918).

Thus, any debate in the present situation as to whether the district court erred in a matter of discretion or in a matter of law reduces itself to a mere play on words. The real issue is whether authoritative precedents of this Court required that the bankruptcy court grant the Attorney General's application. We submit they did, and that the judgment of the Circuit Court of Appeals is proper. Denial of certiorari by this Court will not import any determination contrary to the decision of the court in the *Gardner* case, *supra,* that the bankruptcy court had jurisdiction to pass upon the issues here involved. It will merely signify that there is no basis presented for reviewing an action by the Circuit Court, the possibility of which was plainly contemplated by this Court in the *Gardner* case, *supra,* (329 U. S. at p. 584).

III.

Response to reasons asserted by petitioner as to why writ should issue.

***"First:* The Circuit Court has so far departed from the accepted and usual course of judicial procedure as to call for an exercise of this Court's power of supervision."**

The first contention of petitioner under this heading is that the action of the Circuit Court is at variance with what was decided by this Court in *Gardner* v. *New Jersey, supra,* relying upon the statement in the latter opinion (329 U. S. at p. 584), that "the reorganization court could properly entertain all objections to the claim * * *." In view of the issue presented in the *Gardner* case, *i. e.,* whether the bankruptcy court had jurisdiction in a technical sense to deal

with the various questions raised, and of its decision in the affirmative on that issue, it is obvious that the language quoted by petitioner was merely intended as a paraphrase of that conclusion. It was not intended to negative the proposition that the situation was one in which, notwithstanding the existence of jurisdiction in the technical sense, the state law issues relating to the existence of a settlement contract were appropriately referable to the state courts. Moreover, the reference in the opinion of this Court in that case (329 U. S. at p. 583, 584) to the pendency of the appeal which resulted in the judgment of the Circuit Court of Appeals here sought to be reviewed, demonstrates that the very result now attained was within the distinct contemplation of this Court as a possibility in nowise departing "from the accepted and usual course of judicial procedure."

Petitioner's argument under "B" on page 17 proceeds upon the mistaken hypothesis that the Circuit Court of Appeals was deciding an issue of jurisdiction. Actually, the Court was merely determining which of two forums was the right one for the determination of certain questions of state law. (This is what the Court was actually deciding, whether or not one agrees with its characterization of the issue before it as one of law, rather than of judicial discretion.) In the language from its opinion criticized by petitioner, the Court was merely posing alternative possibilities with respect to the outcome of the meritorious issues, one of which would leave and the other eliminate any policy of conflict with the outstanding Chancery Court injunction. The Court was merely pointing out that if it could be concluded that the federal court could only arrive at that decision of the meritorious questions which would accord with the result in the State Chancery suit,

there would be no occasion for making the reference to the state courts, since no collision between federal and state determinations could arise. There would be neither "friction with state policies," nor disruption of the "appropriate relationship between federal and state authorities functioning as a harmonious whole." *Chicago* v. *Fieldcrest Dairies, supra* (316 U. S. at p. 173). The Court was not making a determination that the existence of "jurisdiction", in the technical sense, could be made to depend upon the prospective outcome of the meritorious issues.

***"Second:* The Circuit Court has decided an important question of Federal law which has not been, but should be settled by this Court."**

In substance, petitioner asserts that the decision of the Circuit Court in some unspecified way conflicts with the provisions granting the bankruptcy court various powers in respect of a bankrupt estate, particularly the power of the court under Section 27 of the Bankruptcy Act to approve a compromise effected by the trustee. We have shown hereinabove on page 18 that the Circuit Court decision neither purported nor was calculated to delegate to the state courts the function of making or approving a compromise between the State and the debtor and trustee, nor did the judgment below impair any other statutory power or right of the bankruptcy court. It only determined that the circumstances were such as to make it appropriate that the aid of the state court with respect to matters of state law be sought by the bankruptcy court to make possible its administration of the estate in reorganization, without any unnecessary and unseemly clash between federal and state jurisdictions.

***"Third:* The Circuit Court of Appeals has decided a Federal question in a way probably in conflict with applicable decisions of this Court."**

Again petitioner asserts that the action of the Circuit Court of Appeals is in conflict with the *Gardner* case and other applicable decisions of this Court. That there is no conflict with the *Gardner* case we think is adequately demonstrated by what we have said hereinabove at pages 24 and 25.

There is no conflict with the decision in *Public Utility Commission of Ohio* v. *Gas Co.*, 315 U. S. 456, since a determination by the state courts that a binding contract does exist between the State and the trustee settling the amount and lien of the state would completely determine the entire tax controversy and eliminate in its entirety all of the federal and constitutional statutory questions involved in the alternative objections of the trustee and the bondholders to the claims asserted on behalf of the State. None of the other decisions of this Court cited by petitioner in any way support the contention that the Circuit Court of Appeals has decided a federal question in a way probably in conflict with applicable decisions of this Court.

Conclusion.

This case involves no matter properly warranting the exercise of the discretionary review of certiorari by this Court and it is respectfully submitted that the prayer for the issuance of a writ of certiorari should be denied.

Respectfully submitted,

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